

**Louisiana Citizens
Property Insurance Corporation**

**Financial Statements and
Supplementary Information
(Statutory Basis)**

December 31, 2009

Under provisions of state law, this report is a public document. A copy of the report has been submitted to the entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

Release Date 12/1/10

Louisiana Citizens Property Insurance Corporation

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Louisiana Citizens Property Insurance Corporation
Metairie, Louisiana

We have audited the accompanying statutory statement of admitted assets, liabilities and accumulated deficit of Louisiana Citizens Property Insurance Corporation ("the Company") as of December 31, 2009, and the related statement of operations, accumulated deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

Except as explained below, we conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described more fully in Note 1 to the financial statement, these financial statements were prepared with the intent of being in conformity with the accounting practices prescribed or permitted by the Louisiana Department of Insurance, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Because of the extent of certain deficiencies in internal controls, we were unable to satisfy ourselves as to the adequacy of the cut-off of beginning balances. The beginning balances as of January 1, 2009, materially affects the determination of the results of operations and cash flows for the year ended December 31, 2009.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the results of operations and cash flows for the year ended December 31, 2009.

In our opinion, the statement of admitted assets, liabilities and accumulated deficit referred to above presents fairly, in all material respects, the admitted assets, liabilities and accumulated deficit of Louisiana Citizens Property Insurance Corporation as of December 31, 2009, on the basis of accounting described in Note 1.

Our audit was conducted for the purpose of forming an opinion on the basic 2009 statutory financial statements taken as a whole. The supplementary information included in Schedules I and II as of and for the year ended December 31, 2009 is presented for complying with the National Association of Insurance Commissioners Accounting Practices and Procedures Manual

and is not a required part of the basic 2009 statutory statements. This additional information is the responsibility of the Company's management. Information related to balance sheet data has been subjected to the auditing procedures applied in our audit of the basic statutory financial statements, and in our opinion, is fairly stated in all material respects when considered in relation to the 2009 statutory statement of admitted assets, liabilities and accumulated deficit taken as a whole.

This report is intended solely for the information and use of the board of directors and management of Louisiana Citizens Property Insurance Corporation and for filing with the Insurance Department of the State of Louisiana and is not intended to be and should not be used by anyone other than these specified parties.

Carr, Legg & Ingram, L.L.C.

New Orleans, Louisiana
August 31, 2010

Louisiana Citizens Property Insurance Corporation

Statutory Statement of Admitted Assets, Liabilities and Accumulated Deficit

December 31, 2009

Admitted Assets

Equity investments	\$ 155,017,422
Cash and short-term investments	133,370,885
Premium receivables and agent's balances, net	18,533,915
Reinsurance receivable	4,708,626
Admitted electronic data processing equipment and software, at cost less accumulated depreciation of approximately \$11,164,000	3,633,494
Emergency assessments receivable - 2005	930,055,000
Emergency assessments receivable - companies	23,350,728
Assets held in trust	35,000,000
Other receivables	221,053

Total admitted assets	\$ 1,303,891,123
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Liabilities and Accumulated Deficit

Liabilities:

Loss reserves	\$ 177,116,926
Loss adjustment reserves	15,716,957
Commissions payable to agents	2,015,695
Unearned premiums	115,473,444
Taxes, licenses, and fees due or accrued	3,630,184
Provision for reinsurance	1,602,629
Accounts payable and other accrued expenses	2,589,434
Amounts retained or withheld for others	21,638
Ceded reinsurance premiums payable, net of ceding commissions	(3,460,019)
Unearned tax exempt surcharge	3,289,374
Interest payable	4,123,786
Bonds payable	950,606,693
Liability for funds restricted for debt service (Note 6)	59,726,032

Total liabilities	1,332,452,773
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Commitments and contingencies (Note 12)

Deficit:

Unassigned deficit	(28,561,650)
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Total accumulated deficit	(28,561,650)
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Total liabilities and accumulated deficit	\$ 1,303,891,123
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See notes to statutory basis financial statements.

Louisiana Citizens Property Insurance Corporation

Statutory Statement of Operations

Year ended December 31, 2009

Revenues

Premiums earned	\$ 171,464,125
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Losses and underwriting expenses

Losses incurred	107,955,134
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Loss adjustment expenses incurred	5,150,164
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Other underwriting expenses	40,892,388
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Total losses and underwriting expenses	153,997,686
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Net underwriting gain	17,466,439
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Net investment income	2,128,466
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Interest expense	(57,629,335)
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Emergency assessment income	52,014,883
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Application and other miscellaneous fee income	2,718,990
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Finances and service charges not included in premiums	734,285
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Net loss from agent's or premium balances charged off	(1,584,426)
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Net income	\$ 15,849,302
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See notes to statutory basis financial statements.

Louisiana Citizens Property Insurance Corporation

Statutory Statement of Changes in Accumulated Deficit

Year ended December 31, 2009

UNASSIGNED DEFICIT, beginning of year	\$ (7,032,287)
Net income	15,849,302
Change in nonadmitted assets	(5,431,906)
Change in provision for reinsurance	3,740,513
Cummulative effect of change in accounting principles	(47,384,394)
Change in tax exempt surcharge	6,835,806
Other gains and losses in surplus	4,861,316
UNASSIGNED DEFICIT, end of year	\$ (28,561,650)

See notes to statutory basis financial statements.

Louisiana Citizens Property Insurance Corporation

Statutory Statement of Cash Flows

Year ended December 31, 2009

Operating Activities

Premiums, policy proceeds, and other considerations received, net of reinsurance	\$ 177,566,427
Underwriting expenses paid	(65,819,506)
Investment income received	(55,495,941)
Other revenues received	57,778,290
Losses and loss adjustment expenses paid	(38,199,944)
Net cash provided by operating activities	75,829,326

Investing Activities

Proceeds from investments sold or matured	317,897,713
Cost of investments acquired	(323,423,754)
Net cash used in investing activities	(5,526,041)

Financing Activities and Miscellaneous

Payments on borrowed funds	(53,685,239)
Other cash provided	52,884,408
Net cash used in financing activities and miscellaneous	(800,831)

Net increase in cash and short-term investments

69,502,454

Cash and short-term investments, beginning of year

63,868,431

Cash and short-term investments, end of year

\$ 133,370,885

See notes to statutory basis financial statements.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 1 – ORGANIZATION AND FINANCIAL STATEMENT PRESENTATION

Louisiana Citizens Property Insurance Corporation (the "Company") is a component unit of the State of Louisiana. The Company's principal business activity is to operate insurance plans which provide property insurance for residential and commercial property, solely for applicants who in good faith entitled, but are unable to procure insurance through the voluntary market. Louisiana Citizens Property Insurance Corporation was created in accordance with provisions of Louisiana Revised Statute (LRS) 22:2293 and began operations on January 1, 2004. The Company operates solely in Louisiana. The Company operates residual market insurance programs designated as the Coastal Plan and the Fair Access to Insurance Requirements Plan (FAIR Plan). The Coastal Plan is for property insurance written on locations between the Gulf of Mexico and the Intracoastal Waterway and the FAIR Plan is for property insurance above the Intracoastal Waterway.

The Company is governed by a board of directors consisting of fifteen members, who serve without compensation. The Board consists of the Commissioner of the Department of Insurance, the State Treasurer, the chairman of the House Committee on Insurance, the chairman of the Senate Committee on Insurance or their designees, six representatives appointed by the Governor, two members appointed by the Commissioner of the Louisiana Department of Insurance, and three members appointed by the Governor.

The accompanying financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Louisiana Department of Insurance. The State of Louisiana generally requires that insurance companies domiciled in the State of Louisiana prepare their statutory basis financial statements in accordance with the National Association of Insurance Commissioners (NAIC) Accounting Practices and Procedures Manual. Such practices vary from accounting principles generally accepted in the United States of America (GAAP). The more significant variances from GAAP are as follows:

- Commissions and other costs of acquiring insurance are expensed when incurred rather than capitalized and amortized over the terms of the related policies as required by GAAP.
- Certain assets designated as "nonadmitted" are excluded from the balance sheet and are charged directly to unassigned surplus.
- Reserves for losses and loss adjustment expenses are reported net, rather than gross, of certain reinsurance recoverables.
- The statement of cash flows is presented in the required statutory format. This format differs from the format specified by GAAP which requires a reconciliation of net income to net cash flow from operating activities and supplemental schedules of noncash financing and investing activities.
- Comprehensive income and its components are not presented in the financial statements as is required by Accounting Standards Codification (ASC) 220, *Comprehensive Income*.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 1 – ORGANIZATION AND FINANCIAL STATEMENT PRESENTATION (Continued)

- Cash and short-term investments in the statement of cash flows represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less. Also, under GAAP, short-term investments are disclosed separately from cash and include investments with remaining maturities of one year or less.

The aggregate effect on the accompanying statutory financial statements of the variations from GAAP is outlined in Note 11 to the financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in conformity with accounting practices prescribed or permitted by the Louisiana Department of Insurance which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

In connection with the preparation of the financial statements, management of the Company evaluated subsequent events through August 31, 2010, which was the date the financial statements were available to be issued.

Cash and Short-Term Investments

For the purpose of reporting cash flows, cash and short-term investments include all liquid investments with a maturity of one year or less when purchased. Short-term investments are stated at market, which approximates fair value. The Company holds cash of approximately \$105 million and short-term investments of approximately \$28 million.

Equity Investments

Equity investments held by the Company represent money market mutual funds. Shares of mutual funds, regardless of the underlying security, are considered to be shares of common stock and are reported as such as designated by NAIC reporting requirements. These funds, for fair value purposes are stated at market, which approximated fair value.

EDP Equipment and Operating System Software

The State has adopted certain prescribed accounting practices that differ from NAIC statutory requirements. Specifically, the maximum depreciable useful life for electronic data processing (EDP) equipment and operating system software is prescribed to be ten years and five years, respectively. NAIC statutory requirements state that EDP equipment and operating system software shall be depreciated for a period not to exceed three years. The Commissioner of Insurance has the right to permit other specific practices that deviate from prescribed practices. Depreciation expense for admitted EDP equipment and operating system software in 2009 approximated \$2,650,000.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Depopulation

The Company is required to undertake a depopulation effort annually per Louisiana state statute LARS 22:2314. The Company accounts for premiums of depopulated policies as a reduction of direct premiums written. Losses and other costs associated with depopulated policies are assumed by the acquiring entity and thus are removed from the Company's financial statements.

Loss Reserves and Loss Adjustment Expense Reserves

The liabilities for losses and loss adjustment expenses include an amount determined from loss reports and individual cases and an amount, based on historical data, for losses incurred but not reported. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in current earnings.

Premiums

Premiums are recorded as earned on a daily pro rata basis over the policy period. The portion of premiums not earned as of the end of the period are recorded as unearned premiums.

Premiums receivable includes amounts due from policyholders for billed premiums. Billings are calculated using the annual premiums for each policy and are paid either through an installment plan offered by the Company or in their entirety at the inception of the policy.

Market Risk

The Company underwrites residential and commercial property insurance policies in the State of Louisiana through the Coastal Plan and the FAIR Plan. Therefore, adverse economic changes or certain changes in the insurance laws of the State of Louisiana could have a significant impact on the Company's future financial position and results of operations.

The Coastal Plan is for property insurance written on locations between the Gulf of Mexico and the Intracoastal Waterway. The FAIR Plan is for property insurance above the Intracoastal Waterway. Therefore, severe storm activity in any of these areas or throughout the State of Louisiana could have a significant impact on the Company's future financial position and results of operations.

Assessments

In the event that the Governing Board of the Company determines that a deficit exists in either the Coastal Plan or the FAIR Plan, the Company may levy a regular assessment for each affected Plan in order to remedy any deficit. All insurers who become authorized and then engage in writing property insurance within Louisiana shall participate in regular assessment of the Coastal and FAIR Plans in the proportion that the net direct premium of such participant written in the State during the preceding calendar years bears to the aggregate net direct premiums written in the State by all insurers during the preceding calendar year as certified to the Governing Board by the Louisiana Insurance Rating Commission.

When the deficit incurred in a particular calendar year is not greater than ten percent of the aggregate state wide direct written premium for the subject lines of business for the prior calendar year, the entire deficit will be recovered through regular assessments. When the

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

deficit incurred exceeds ten percent, the regular assessment may not exceed the greater of ten percent of the calendar year deficit, or ten percent of the aggregate statewide direct written premium for the subject lines of business for the prior calendar year. Any remaining deficit shall be recovered through an emergency assessment.

All persons who procure a policy of insurance of one or more subject lines of business from an insurer who becomes authorized and then engages in writing property insurance within Louisiana from the FAIR or Coastal Plans are subject to emergency assessment by the Company.

Upon determination by the Governing Board of the Company that a deficit exceeds the amount allowed to be recovered through regular assessment, the governing Board shall levy an emergency assessment for as many years as necessary to cover all deficits. The amount of emergency assessment levied in a particular year shall be a uniform percentage of that year's direct written premium for the subject lines of business. The total amount of emergency assessment levied in any calendar year will not exceed the greater of: (a) ten percent of the amount needed to cover the original deficit plus interest, fees, commissions, required reserves, and other costs associated with the financing of the original deficit, or (b) ten percent of the aggregate state wide direct written premiums for subject lines of business and for all plan accounts of the Company for the prior year, plus interest, fees, commissions, required reserves, and other costs associated with financing the original deficit. To the extent the aggregate amount of the emergency assessment will not exceed the greater of (a) or (b) above, the governing Board shall impose an emergency assessment in the amount required by any applicable loan agreement, trust indenture or other financing agreement.

Liability for Funds Restricted For Debt Service and Related Accounting Changes

The Commissioner of Insurance has the right to permit other specific practices that deviate from prescribed practices. During the second quarter of 2009, with agreement from the Louisiana Department of Insurance ("the Department"), the Company received permission from the Department to reclassify, as a liability, the excess emergency assessments collected that were greater than the debt service costs since the inception of the bond debt in 2006 with the cumulative excess amount being \$59,726,032 at December 31, 2009. The Company reclassified excess collections from 2006 to 2008 of \$47,384,394 that were previously recognized as income as an offsetting decrease to a surplus account entitled "cumulative effect of change in accounting principles". The Company will record emergency assessment collections and costs through net income only in amounts sufficient to offset interest costs and amortization of bond issuance costs.

Reinsurance

Premiums ceded under reinsurance agreements are recorded as a reduction of earned premiums. Reinsurance recoverables on unpaid losses are recorded as a reduction of losses incurred and loss adjustment expenses incurred. Reinsurance recoverable on paid losses are recorded as an asset in the accompanying of admitted assets, liabilities, and accumulated deficit. All catastrophe reinsurance payments are recorded as premiums ceded and are amortized over the life of the hurricane season for which the payments apply. Premiums ceded include catastrophe reinsurances purchases.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

The Company constitutes an integral part of the State of Louisiana and its income is exempt from federal income tax pursuant to Private Letter Ruling 160165-03 from the Internal Revenue Service. Obligations issued by the Company constitute obligations of the State of Louisiana within the meaning of section 103(c)(1) of the Internal Revenue Code.

Financial Instruments

The carrying value of cash and cash equivalents, premiums receivable, other admitted assets and other liabilities approximates fair value given their short-term nature.

Unlike private insurers that are subject to liquidation in the event of insolvency, the Company is able (and statutorily required) to levy assessments in the event of a deficit in any or all of its accounts.

NOTE 3 – REPURCHASE AGREEMENTS

In 2006, the Company entered into a Repurchase Agreement with Societe Generale, New York Branch to invest a portion of the Debt Service Reserve Fund. The agreement requires Societe Generale to maintain margins on collateral of 104% to 105% of market value depending on the type of collateral. Acceptable securities are GNMA, Government Agencies, mortgage backed securities of FHLMC or FHLB and U.S. Treasury securities. The custodian for the collateral is Wells Fargo Bank, N.A.

The fair value and book value, respectively, of collateral accepted from Societe Generale as of December 31, 2009 was approximately \$28,298,000 and \$30,026,000. The collateral percentage was 106.11%.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 4 – LIABILITIES FOR LOSS AND LOSS ADJUSTMENT EXPENSES

Activity in the liabilities for loss and loss adjustment expenses is summarized as follows:

Year ended December 31, 2009 (thousands)

Balance at January 1	\$ 169,692
Incurring related to:	
Current year	48,743
Prior years	
Extra contractual obligations	105,921
Policyholder obligations	(23,559)
Total incurred	131,105
Paid related to:	
Current year	32,435
Prior years	
Extra contractual obligations	6,000
Policyholder obligations	69,528
Total paid	107,963
Balance at December 31	\$ 192,834

For both catastrophic and non-catastrophic claims, the loss adjusting function is performed by the Company through its employees and through contracted independent adjusting firms. The Company compensates the independent adjusting firms, depending upon the type or nature of the claims, either on per-day rate or on a graduated fee scheduled based on the gross claim amount, consistent with industry standard methods of compensation.

The Company is involved in a number of class action lawsuits and other legal proceedings arising out of various aspects of its business which have been reserved for above and are included in prior year losses incurred in 2009. See Note 12 for a description of these class action claims.

NOTE 5 – AGENT COMMISSIONS AND SERVICING COMPANY FEES

The Company has contracted with various insurance agents licensed in the State of Louisiana. These agreements provide for commissions to be paid to the agents at rates established by the Board and calculated as a percentage of direct written premiums, net of certain surcharges and assessments. Agent commissions included in other underwriting expenses incurred were approximately \$25 million during 2009.

Additionally, the Company has entered into agreements with two servicing companies to provide underwriting and policy management services. The agreements provide for monthly compensation to the company based on a "Per Transaction Fee" applied to the number of transactions processed in a monthly cycle. During 2009, the servicing agreements were

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 5 – AGENT COMMISSIONS AND SERVICING COMPANY FEES (Continued)

extended through September 30, 2010 on the same (or similar) terms. Servicing company fees incurred and included in other underwriting expenses incurred were approximately \$5 million during 2009. In addition, no agents or servicing companies have been paid more than 5% of surplus in 2009.

NOTE 6 – CAPITAL AND ACCUMULATED DEFICIT

Changes in balances of surplus (deficit) from the prior year are, in part, due to collections made by the Company during the normal course of collecting policy component charges. The policy component charge affecting surplus funds is the tax exempt surcharge.

In 2005, the Company suffered losses of \$1.3 billion as a result of hurricanes Katrina and Rita. In 2006, the Company issued \$978.2 million of bonds to pay for these losses. Under LRS 22:2291, the Company may assess, in any one year, up to 10% of the total property taxes assessable state-wide to pay the debt service on the bonds. The total statewide assessable premiums are approximately \$2 billion.

Emergency assessments were as follows:

Years ended December 31,		
2007	3.6% assessment rate	\$ 78,012,088
2008	5.0% assessment rate	99,751,686
2009	5.0% assessment rate	116,401,088
		294,164,862
Plus: bond earnings 2006-2009		42,260,638
Less : debt service 2006-2009		(276,699,468)
Liability for funds restricted for debt service		\$ 59,726,032

The unassigned deficit approximated \$28.6 million at December 31, 2009. Approximately \$684.4 million of future emergency assessments are attributed to the 2005 operating loss.

NOTE 7 – REINSURANCE AGREEMENTS

The Company purchases private reinsurance through Aon Benfield, Inc., as a licensed reinsurance intermediary. The participating reinsurance companies will reimburse the Company, through the intermediary, a specified percentage of losses incurred if a prescribed retention is reached.

The Company purchases reinsurance based on levels of loss. The Company is liable for the first amount of ultimate net loss, shown in the table below as "Company Retention", arising out of each loss occurrence. The reinsurer is then liable, as respects each excess layer, for the

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 7 – REINSURANCE AGREEMENTS (Continued)

amount by which such ultimate net loss exceeds the Company's applicable retention for that layer. However, the liability of the reinsurer under any excess layer of reinsurance coverage provided does not exceed either of the following: (1) the amount shown below as "Reinsurer Per Occurrence Limit" for that excess layer as respects loss or losses arising out of any one loss occurrence, or (2) the amount shown as "Reinsurer's Term Limit" for that excess layer. Each excess layer of reinsurance coverage provided is as follows:

	January 1, 2009 to May 31, 2009		June 1, 2009 to December 31, 2009	
	First Excess	Second Excess	First Excess	Second Excess
Company's Retention	\$ 200,000,000	\$ 400,000,000	\$ 100,000,000	\$ 200,000,000
Reinsurer's Per Occurrence Limit	\$ 200,000,000	\$ 300,000,000	\$ 100,000,000	\$ 300,000,000
Reinsurer's Term Limit	\$ 400,000,000	\$ 600,000,000	\$ 200,000,000	\$ 600,000,000
Annual Minimum Premium	\$ 25,600,000	\$ 26,400,000	\$ 19,800,000	\$ 40,400,000
Adjustment Rate	0.104575%	0.107843%	0.09000%	0.183636%

In the event that all or any portion of the reinsurance under the excess layer above is exhausted by loss, the amount exhausted can be reinstated immediately if the Company agrees to pay additional premium. The premium for each excess layer of reinsurance coverage provided is the greater of the following: (1) the "Annual Minimum Premium" as shown above; or (2) the percentage, shown as "Adjustment Rate" above for that excess layer of the Company's aggregate wind total insured limit for business in force as of September 30, 2009 which is estimated to be \$27,500,000,000.

The effect of reinsurance on premiums written and earned is as follows:

Year ended December 31, 2009

	Premiums	
	Written	Earned
Direct	\$ 222,251,490	\$ 248,602,887
Ceded	(55,854,664)	(77,138,762)
Net premiums	\$ 166,396,826	\$ 171,464,125

Amounts recoverable from reinsurers on unpaid losses and loss adjustment expenses are estimated based on the allocation of estimated unpaid losses and loss adjustment expenses among coverage lines. Actual amount recoverable will depend on the ultimate settlement of losses and loss adjustment expenses. Reinsurance contracts do not relieve the Company from its obligation to policyholders. The Company remains liable to its policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under their reinsurance agreements.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 7 – REINSURANCE AGREEMENTS (Continued)

The reserve for uncollectable reinsurance recoverables during the year ended December 31, 2009 was as follows:

Year-ended December 31, 2009

AXA Re	\$ 754,043
Lehman Reinsurance Co. Ltd.	647,143
PXRE Reinsurance Ltd.	12,932
Quanta Reinsurance Ltd.	188,511
	\$ 1,602,629

NOTE 8 – BONDS PAYABLE

Series 2006B – During April 2006, the Company issued \$678,205,000 of assessment revenue bonds for the purpose of redeeming bond anticipation notes issued to finance, on an interim basis, a portion of the Plan Year Deficit for 2005 in the FAIR Plan resulting from Hurricanes Katrina and Rita, to finance the balance of the Plan Year Deficit for 2005, to make deposits to the Capitalized Interest Fund and the Debt Service Reserve Fund and to pay costs of issuance. The bonds were issued in denominations of \$5,000 or any integral multiple thereof. The 2006B bonds bear interest ranging from 4.00% to 5.25% per annum, payable semiannually on June 1 and December 1 of each year, commencing December 1, 2006. The bonds are secured, together with additional bonds, if any, by pledged revenues, which include primarily the 2005 Emergency Assessments. The bonds are not secured by the full faith and credit of the State of Louisiana. Payment of the principal of and interest on the bonds when due is insured by a bond insurance policy. The bond maturity dates range from June 1, 2009 to June 1, 2023. Bond principal payments of \$31,800,000 were made in 2009.

Series 2006C1 through 2006C4 – During April 2006, the Company issued \$300,000,000 of assessment revenue bonds at auction rate for the purpose of redeeming bond anticipation notes issued to finance, on an interim basis, a portion of the Plan Year Deficit for 2005 in the FAIR Plan resulting from Hurricanes Katrina and Rita, to finance the balance of the Plan Year Deficit for 2005, to make deposits to the Capitalized Interest Fund and the Debt Service Reserve Fund and to pay cost of issuance. The bonds were issued in denominations of \$25,000 or any integral multiple thereof. Prior to their remarketing explained below, interest on the bonds adjusted based upon 35-day Auction Periods. Generally, the interest payment date for an auction period was the business day immediately following each auction period. The length of the auction period with respect to the bonds could be changed at the option of the Company in accordance with the auction agreement. The bonds are secured, together with additional bonds, if any, by pledged revenues, which include primarily the 2005 Emergency Assessments.

The bonds are not secured by the full faith and credit of the State of Louisiana. Payment of the principal and interest on the bonds when due is insured by a bond insurance policy. The bonds were reoffered in March 2009 after the Auction Rate Securities market collapsed.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 8 – BONDS PAYABLE (Continued)

During March 2009, the 2006C1 through 2006C4 series were reoffered in connection with the conversion of the interest rate from the auction mode rate to the long term interest rate and the remarketing of the 2006C bonds. In connection with the conversion and remarketing of the Series 2006C bonds, the original seventh supplement indenture was amended and restated by the amended and restated seventh supplemental indenture of trust dated as of April 1, 2009. The Series 2006B bonds were originally issued for the purpose of providing funds to redeem bond anticipation notes issued to finance, on an interim basis, a portion of the Plan Year Deficit for 2005 in the FAIR Plan resulting from hurricanes Katrina and Rita, to finance the balance of the Plan Year Deficit for 2005, to make deposits to the capitalized interest fund and the debt service reserve fund for the Series 2006C bonds and to pay costs of issuance. The Series 2006C bonds were remarketed in fully registered form without coupons in denominations of \$5,000 or any integral multiple thereof. On and after the respective conversion dated of each subseries of the series 2006C bonds, interest on the bonds is payable on each June 1 and December 1 commencing June 1, 2009, until maturity or prior redemption and the bonds were converted to the long-term interest rate on May 6, 2009. The 2006C bonds bear interest ranging from 2.75% to 6.75% per annum. On and after the respective conversion dates of each subseries of the series 2006C bonds, the scheduled payment of principal and interest on such subseries of the bonds, when due, is guaranteed under a financial guaranty insurance policy issued concurrently with the delivery of such subseries of the 2006C bonds by Assured Guaranty Corp. The Series 2006C bonds are subject to optional redemption prior to maturity. The bond maturity dates range from June 1, 2009 to June 1, 2026. Principal payments were \$16,350,000 in 2009.

A schedule of debt service requirements, including bond premiums and discounts, is as follows:

<u>Maturity</u>	
2010	\$ 36,219,390
2011	38,209,339
2012	40,404,358
2013	42,761,945
2014	45,318,364
2015-2019	262,310,524
2020-2024	328,400,297
2025-2029	156,982,477
	<u>\$ 950,606,694</u>

Unamortized premium at December 31, 2009 was approximately \$21 million.

The total interest expense on the fixed rate bonds for the years ended December 31, 2009 was approximately \$43.4 million including amortized premium of \$1 million, and is included in "Interest expense, net" in the accompanying Statutory Statement of Operations.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 9 – RETIREMENT PLAN

Prior to September 1, 2008, the Company sponsored a non-contributory defined benefit pension plan covering all employees that were hired prior to April 1, 2008, through a services agreement with Property Insurance Association of Louisiana (PIAL) in which retirement expenses were previously reimbursed to PIAL. As of September 1, 2008, the Company froze its defined benefit pension plan and converted it to a defined contribution plan. The Company contributes 11% of each employee's wages to the defined contribution plan. Contributions are expensed each month and the Company carried no assets or liabilities for the defined contribution plan on its statement of admitted assets, liabilities and surplus. The Company's contribution to the plan was approximately \$146,000 in 2009.

NOTE 10 – LEASES

The Company is obligated under certain non-cancelable operating leases for office space that will expire at various dates. The future minimum payments as of December 31, 2009 follow:

<i>Years ending December 31,</i>	<i>2009</i>
2010	\$ 443,375
2011	446,158
2012	449,026
2013	451,964
2014	264,666
	\$ 2,055,189

Rental expense for 2009 was approximately \$450,000.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 11 – RECONCILIATION WITH GAAP, STAT AND WITH AMOUNTS FILED WITH THE STATE INSURANCE DEPARTMENT

Accounting principles generally accepted in the United States of America (GAAP basis) differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (statutory basis). A reconciliation between the change in net assets and the deficiency in net assets as reported under GAAP basis and statutory basis as well as a reconciliation of amounts in the accompanying statutory basis financial statements with annual report amounts filed with the Louisiana Department of Insurance follows:

Year ended December 31, 2009

Change in net assets - GAAP basis	\$ 71,794,336
Adjustments to:	
Policy acquisition costs	397,995
Pension plan expense	739,032
Note issuance costs	7,877,098
Allowance for doubtful accounts	(559,501)
Excess regular assessment recoupments	(246,155)
Excess emergency assessments	(56,597,093)
Tax exempt surcharge	(7,556,410)
Net income - Statutory basis	\$ 15,849,302

December 31, 2009

Total deficiency in net assets - GAAP basis	\$ (869,325,645)
Adjustments to:	
Non-admitted assets	(5,242,442)
Policy acquisition costs	(10,840,186)
Postretirement benefit liability	739,032
Note issuance costs	(13,417,297)
Excess emergency assessments	(59,726,032)
Allowance for doubtful accounts	798,549
Assessments receivable	930,055,000
Provision for reinsurance	(1,602,629)
Accumulated surplus (deficit) - Statutory basis	\$ (28,561,650)

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 11 – RECONCILIATION WITH GAAP, STAT AND WITH AMOUNTS FILED WITH THE STATE INSURANCE DEPARTMENT (Continued)

Year ended December 31, 2009

Net Income - Annual Statement	\$ 58,487,832
Adjustments to:	
Direct premium written	1,087,322
Emergency assessment income	(3,894,557)
Direct claims loss paid	(47,696,038)
Loss adjustment expense	7,864,743
Net income - Statutory basis	\$ 15,849,302

December 31, 2009

Accumulated surplus - Annual statement	\$ 11,269,648
Adjustments to:	
Funds held in trust	\$ 18,000,000
Loss reserves	(65,696,038)
Loss adjustment reserves	7,864,740
Net income - Statutory basis	\$ (28,561,650)

NOTE 12 – COMMITMENTS AND CONTINGENCIES

The Company is involved in certain litigation and disputes incidental to its operations. In the opinion of management, after consultation with legal counsel, there are substantial defenses to such litigation and disputes and any ultimate liability, in excess of reserves resulting there from, will not have a material adverse effect on the Company's financial condition or results of operations.

The Company is also involved in other potentially significant litigation described below; any of which could have a material adverse effect on the financial condition or results of operations. These matters raise difficult and complicated factual and legal issues and are subject to many uncertainties and complexities, including the underlying facts of each matter; novel legal issues; variations between jurisdictions in which matters are being litigated, heard, or investigated; differences in applicable laws and judicial interpretations; the length of time before many of these matters might be resolved by settlement, through litigation or otherwise; and the current legal environment faced by large corporations and insurance companies.

The outcome of these matters may be affected by decisions, verdicts, settlements and the timing of such in other individual and class action lawsuits that involve the Company, other insurers, or other entities and by other legal, governmental, and regulatory actions that involve the Company, other insurers, or other entities. The outcome may also be affected by future state legislation, the timing or substance of which cannot be predicted.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 12 – COMMITMENTS AND CONTINGENCIES (Continued)

In lawsuits, plaintiffs seek a variety of remedies. In some cases, the monetary damages sought include punitive or treble damages. Often specific information about the relief sought, such as the amount of damages is not available. When specific monetary demands are made, they are often set just below a state court jurisdictional limit in order to seek the maximum amount available regardless of the specifics of the case.

For the reasons previously specified, it is often not possible to make meaningful estimates of the amount or range of loss that could result from the known and unknown matters described. The Company reviews these matters on an ongoing basis and follows appropriate accounting guidance when making accrual and disclosure decisions. When assessing "reasonably possible" and "probable" outcomes, the Company bases its decisions on its assessment of the ultimate outcome following all appeals. Additionally, in instances where a judgment, assessment or fine has been rendered against the Company, there is a presumption that criteria in reaching a "reasonably possible" and "probable" outcome has been met. In such instances, the amount of liability recorded by the Company will include the anticipated settlement amount, legal costs, insurance recoveries and other related amounts and take into account factors such as the nature of the litigation, progress of the case, opinions of legal counsel, and management's intended response to the litigation, claim, or assessment.

Due to the complexity and scope of the matters disclosed below and the many uncertainties that exist, the ultimate outcome of these matters cannot be reasonably predicted. In the event of an unfavorable outcome in any one or more of these matters, the ultimate liability may be in excess of amounts currently reserved.

A summary of potentially significant litigation follows:

Geraldine Oubre v. Louisiana Citizens: This is a class action. The plaintiffs allege that the Company failed to timely initiate loss adjustment for claims related to the occurrences of Katrina and Rita. Efforts to defeat class certification failed at the trial court level, the Fifth Circuit Court of Appeal and the Louisiana Supreme Court. The Company's motion for a new trial was denied by the court. On May 2, 2010, the Company argued before the fifth Circuit Court of Appeal and is awaiting a ruling as to the appeal. The Company will file an Application for Supervisory Writs to the Louisiana Supreme Court if they do not prevail with the Fifth Circuit Court.

In the interim, the plaintiffs have filed another wave of motions for summary judgment. The value of this wave of motions for summary judgment is somewhere in the range of \$50 million, thus bringing the total potential judgment to \$140 million plus judicial interest from the date of judgment.

Nonetheless, it is certain that this matter cannot resolve itself for any amount below \$6 million, which has been deposited with the trial court in August, 2009. In July 2010, the Louisiana Supreme Court, in keeping with its plenary supervisory jurisdiction, ordered that all further proceedings in both the Oubre and Orrill cases be stayed pending its consideration of the company writ application. The Company has recorded approximately \$92.8 million in reserves associated with this case as a result of a judgment which was rendered by the trial court. See Note 4 above.

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 12 – COMMITMENTS AND CONTINGENCIES (Continued)

Toni Swain Orrill v. Louisiana Citizens: This is a class action claiming allegations of bad faith with respect to the failure to timely initiate a loss adjustment as well as the failure to timely pay insurance benefits upon receipt of satisfactory proof of loss relating to Katrina and Rita claims. The Company entered into a stipulation of settlement with the Orrill class, which settlement was approved by the trial court, whereby the claims would be settled for \$1,000 per claimant, up to a total amount of \$30 million dollars and \$5 million in attorney's fees.

On April 21, 2010, the Court of Appeal issued its ruling, finding that the settlement unfairly affected the rights of the class in Oubre, and issued an order vacating the settlement and remanding the case to trial court for further proceedings.

An Application for Supervisory Writs with the Louisiana Supreme Court has been filed asking them to review the decision. If the court denies the writ, this matter will be remanded to the trial court for further proceedings, and the Company may continue in their efforts to settle the case.

In July 2010, the Louisiana Supreme Court, in keeping with its plenary supervisory jurisdiction, ordered that all further proceedings in both the Oubre and Orrill cases be stayed pending its consideration of the company writ application. A reserve of \$18 million has been recorded by the Company. See Note 4 above

Stephanie Press v. Louisiana Citizens: This is a class action whereby the Company failed to provide General Contractor Overhead and Profit (GCOP) for the claims of those insured who sustained damage as a result of Katrina and Rita, and whose damages claims necessitated the retention of three or more trades to complete the necessary renovations/repairs, and as per the Company policy.

The Company engaged in settlement discussions with the plaintiff's class counsel, and was able to reach a settlement of this entire class action for \$23 million, which was paid subsequent to December 31, 2009. Accordingly, a reserve of \$23 million has been recorded by the Company. See Note 4 above.

Tracy Thibodeaux, et al. v. Louisiana Citizens: This class action alleges that the Company improperly charged an application fee of \$65 that was not included in the dollar amount of the premium disclosed on the policy of the insurance delivered which constitutes a violation of La. Rev. Stat. 22:627. The plaintiffs seek a refund of the application fee to all individuals who were charged this fee.

The plaintiffs' attorney has discussed with the Company and agreed to withhold class notice being issued until the Company has litigated the substantive issue as to whether the application fee charged by Louisiana Citizen's constitutes a premium which should be specifically listed on the declaration page.

The Company believes that there is a likelihood that they may be able to prevail in this action. However, should the court determine that L.R.S. 22:627 should be strictly construed, and that the application fee does constitute a portion of the premium which

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 12 – COMMITMENTS AND CONTINGENCIES (Continued)

must be disclosed, then the Company may be exposed to a judgment that will order them to return the application fee to as many as 178,000 applicants. Since this class action is in discovery stage, no reserve has been recorded by the Company.

Slidell Property Management, LLC v. Louisiana Citizens: This case represents a first-party mass joinder claim alleging that Slidell Property Management is the owner of 43 residences located on Clarise Court in Slidell, La, where "Chinese Drywall" was used in the construction of these homes. The Plaintiff claims substantial property damage in the form of corrosion to air conditioner coils, refrigerator coils, copper tubing, electrical wiring, computer wiring and other household items resulting from the sulfuric gases and other vapors coming from the defective drywall.

LCPIC has a right to litigate coverage issues where it appears that the coverage exclusions contained within the LCPIC policy should serve to exclude coverage for the alleged damages. Furthermore, based on the applicable policy periods of each policy, it is possible that the "loss event" – if construed as the installation of the Chinese Drywall rather than the manifestation of damages related to such drywall – occurred outside the policy period. Since this action is in discovery stage, no reserve has been recorded by the Company.

The Company participated in an arbitration proceeding initiated by a third party service provider related to a dispute that arose between the parties over the quality of adjusting services performed and adequacy of payments made for those services provided relating to Hurricane Katrina claims. Phase one and phase two of arbitration has resulted in an award against the Company in the amount of approximately \$2.5 million in July 2010. Accordingly, a reserve of approximately \$2 million has been recorded by the Company. See Note 4 above.

The Company participated in arbitration involving damages resulting from a third party technology company's failure to provide contracted-for services in a professional and workmanlike manner. Settlement of those claims has been completed with an award in the Company's favor of approximately \$500,000 in early 2010.

A firm represents the Company in connection with a litigation brought by the Company against J.P. Morgan Securities, Inc. and Bear Stearns & Co., Inc., regarding the Company's issuance in 2006 of Auction Rate Securities. Currently the Company expects to arbitrate that case. No counter claims are expected.

Various other lawsuits against the Company have arisen in the course of the Company's business, including in excess of 3000 pending suits as of December 31, 2009 associated with hurricanes Rita and Katrina which occurred in 2005. The Company believes it has established appropriate reserves for all lawsuits, including approximately \$26 million associated with claims associated with Hurricanes Rita and Katrina, in addition to class action claims described above. The Company has no assets that it considers to be impaired.

In addition to claims under the insurance policies it issues, the Company is potentially exposed to various risks of loss, including those related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. As of the end of

Louisiana Citizens Property Insurance Corporation

Notes to Statutory Financial Statements

NOTE 12 – COMMITMENTS AND CONTINGENCIES (Continued)

2009, the Company had insurance protection in place from various commercial insurance carriers covering various exposures, including workers' compensation, property loss, employee liability, general liability, and directors and officers' liability. Management continuously revisits the limits of coverage and believes that current coverage is adequate. There were no significant reductions in insurance coverage from the previous year.

NOTE 13 – DEPOPULATION

The Louisiana State Legislature created the Company to operate insurance plans as a residual market for residential and commercial property. The legislature further intended that the Company work toward the ultimate depopulation of these residual market plans also known as the Coastal Plan and the FAIR plan. To encourage the ultimate depopulation of these residual market plans, the Louisiana Citizens Property Insurance Corporation Policy Take-Out Program was created.

Under the take-out plan guidelines, not less than once per calendar year, the Company will offer its in-force policies for removal to the voluntary market. The in-force policies will be bundled in groups of not less than five hundred policies and include both policies issued under the Coastal Plan and the FAIR Plan. The Company will include policies in the bundle with geographic and risk characteristics that serve to reduce the exposure of the corporation. The bundles must include both of the following: (1) 25% of the policies must be policies which provide coverage to structures located in L.R.S. 40:1730.27; and (2) at least 75% of which net premiums are received from policyholders will be from insurance policies covering single-family residential structures, residential duplex structures, or residential forplex structures. Each insurer admitted to write homeowners insurance or insurance which covers commercial structures in the state of Louisiana may submit a take-out plan to the Company for the bundled policies. The Company will submit each take-out plan to the Department of Insurance for review and approval.

Policies may be removed from the Company at policy renewal or as part of a bulk assumption. In an assumption, the take-out company is responsible for losses occurring from the assumption date through the expiration of the Company's policy period.

Unearned premiums remitted to take-out companies pursuant to assumption agreements is reflected as a reduction in "Premiums earned" in the Statutory Statement of Operations and totaled \$5,603,080 for the year ended December 31, 2009.

The Company provides administration services with respect to the assumed policies. All agreements provide for the take-out company to adjust losses. The take-out company pays a ceding commission to the Company to compensate the Company for policy acquisition costs, which includes servicing company fees, agent commissions, and premium taxes. While the Company is not liable to cover claims after the assumption, the Company continues to service policies for items such as policy holder endorsements or cancellation refunds. Should the Company process and provide a refund to policyholders, such amount is subsequently collected from the take-out company. At December 31, 2009, assumed premiums in the amount of \$800 were due from certain take-out companies.

Louisiana Citizens Property Insurance Corporation

Schedule I - Summary Investment Information December 31, 2009

	Gross investment holdings		Admitted assets as reported in the annual statement	
	Amount	Percentage	Amount	Percentage
Equity interests:				
Investments in mutual funds	\$155,017,422	53.753%	\$155,017,422	53.753%
Cash, cash equivalents, short-term investments	133,370,885	46.247%	133,370,885	46.247%
Total invested assets	\$288,388,307	100.000%	\$288,388,307	100.000%

See accompanying independent auditors' report.

Louisiana Citizens Property Insurance Corporation

Schedule II - Supplemental Investment Risk Interrogatories December 31, 2009

The following is a summary of certain statutory financial data included in the supplemental investment risk interrogatories.

1. Total admitted assets as reported on the statutory statement of admitted assets, liabilities and accumulated deficit \$1,303,891,123
2. By investment category, the ten largest exposures to a single issuer/borrower/investment, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the *SVO Purposes and Procedures Manual*, as exempt, (ii) property occupied by the Company, and (iii) policy loans.

Issuer	Description of Exposure	Amount	Percentage of total admitted assets
Federated Treas Oblig Fund 398	CS - Money Market Mutual	\$ 155,017,422	12.1%
Repurchase Agreement w/ Societe	Short-Term Investments	28,298,272	2.2%

Interrogatories 3 through 20 are not applicable to the Company.

21. Amounts and percentages of the reporting entity's total admitted assets subject to the following types of agreements:

	At End of Each Quarter				
	At Year-end		1st Quarter	2nd Quarter	3rd Quarter
	1	2	3	4	5
20.02 Repurchase agreements	\$ 28,298,272	2.2%	\$ 40,815,846	\$ 28,298,272	\$ 28,298,272

Interrogatories 22 through 23 are not applicable to the Company.

See accompanying independent auditors' report.



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September 22, 2010

The Board of Governors of
Louisiana Citizens Property Insurance Corporation

Dear Members of Board of Directors:

In planning and performing our audit of the statutory financial statements of Louisiana Citizens Property Insurance Corporation ("the Company") as of and for the year ended December 31, 2009 in accordance with auditing practices prescribed or permitted by the Louisiana Department of Insurance, we considered the Company's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses; therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Company's internal control to be significant deficiencies:

Finding 2009-01
Inadequate Documentation of Information Systems

This item is a repeat of a portion of prior year finding as described in the Auditee's Summary of Prior Audit Findings as Prior Year 2008-14 (see Attachment A), and remains unresolved for DataMart. While LPMS is scheduled to be taken out of service in 2010, LCPIC should require it properly document the code for DataMart.

Finding 2009-02
Inadequate Program/System Change Controls

A change and patch management policy is integral to maintain control and configuration changes for not only the core application systems, but the hardware and operating systems they reside on. Stable and managed production environments require that implementation of changes be predictable and repeatable, following a controlled process that is defined, monitored, and enforced. We evaluated program and system change controls for both applications and operating systems.

Furthermore, the Company has outsourced coding requirements to third party vendors. As such the vendor controls in this area should be considered critical to the Company's IT operations as the Company relies heavily on the expertise of service providers to accomplish IT functions and it

was recommended in prior audits that management obtain documentation for controls evaluations such as SAS 70s and SSAE 16 by the vendors used. LCPIC should establish controls requirements for each of the vendors involved and conduct its own audits or request the vendor obtain independent third party independent evaluations. This should be accomplished as soon as possible.

The Company's operating system updates will be controlled by Windows Update Server; however, this process is not yet complete. A haphazard sample of 10 workstations was selected to review update status for security patches. Three of the 10 workstations had not been updated for greater than 60 days and 1 of the 3 was greater than 180 days. The Company should finalize WSUS implementation.

During testing we noted workstations have not been properly updated with the latest patches and updates from Microsoft. The Company should finalize the setup of WSUS to push and monitor operating system updates

A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the Company's internal control to be a material weakness:

Finding 2009-03
Claims Reserves

During our audit of the statutory financial statements, we reviewed claims and the processes followed to record claims and establish reserves related to expected losses and loss adjustment expense. We identified instances where claims had been closed but still had loss adjustment expense reserves in place; instances where the initial claim reserves were set according to the Company policy but could not determine the basis for which the reserve was established when a suit was filed against the Company on the claim; instances where claim files included an order of dismissal prior to year-end with the files remaining open at year end and reserves not cleared out completely at year end; and instances where loss reserves were in excess of final payment made to settle the claims and with no justification for the amount reserved. Furthermore, the reserved amounts greatly exceeded procedure limits outlined in policies provided to claims processors used by the Company.

While some of these claims did relate to those resulting from Katrina and Rita, many of the claims reviewed were newer claims originating in 2009.

We recommend that the Company implement a stringent review process with more structure in areas such as changes made to the initial reserve recorded by the Service Providers, a more detailed review of reserves that exceed a pre-established threshold set by the Company every 30 days as stipulated in the Company's policies and procedures, and more control of those claims that have entered into litigation status and exceeded the pre-established reserve threshold set by the Company.

Furthermore, a process should be established to ensure that claims that have been closed are closed within the system in a timely manner and that the related loss and loss adjustment expense reserve is eliminated timely.

Finally, all persons involved in the claims and related accounting process should attend various educational training programs including in-house classes and external professional classes in order to keep current on issues related to their duties. Also, through background checks and the

interview process, the company and service provider should ensure that they hire individuals with proper backgrounds for their job positions.

In addition, we noted other matters involving internal control and its operation that we have reported to management of Louisiana Citizens Property Insurance Corporation as follows:

Emergency Assessment Approval

During our audit procedures, we noted that the Company did not obtain proper approval for the 2009 emergency assessment rate as follows:

Directive 198, as issued by the Louisiana Department of Insurance on August 29, 2007, rescinds in its entirety Directive 191 dated December 22, 2005, and mandates the following key requirements as they pertain to Emergency Assessments: subject to verification by the Louisiana Department of Insurance ("DOI"), the Company shall annually determine whether an Emergency Assessment will be levied, and notify assessable insurers as to the assessment percentages.

Per our review of documentation and request of the Louisiana DOI, the Company did not obtain approval from the DOI for the 2009 emergency assessment until July 20, 2010. Therefore, the Company was not in compliance with LSA-R.S. 22:2307(E) for the year ended December 31, 2009. Furthermore, the calculation for the 2009 emergency assessment rate was not mathematically accurate per the DOI's recalculation.

We recommend that the Company follow the prescribed steps in the necessary order as outlined so as to be in compliance with state statute.

Policyholder Eligibility

During our audit procedures, we noted that the Company did not comply with state eligibility requirements as follows:

The Company did not follow state law to ensure that all applicants were eligible to be insured by Louisiana Revised Statute (R.S.) 22:2302(A) which provides that any person having an insurable interest in insurable property and who has been denied coverage by one or more insurers authorized to write property insurance in this state is eligible to apply for insurance through the Company directly or through a representative. R.S. 22:2302(A) further provides that every application form shall require that the applicant disclose each insurance carrier who denied property insurance coverage to the applicant.

The Company's new EPIC system was implemented subsequent to year end and requires a decline from another insurance company in order to complete an application for the Company's policy. The Company expects to have all personal line policies, which represent the majority of the policies written by the Company, fully transitioned to the EPIC system by April 1, 2011. The commercial line conversion will follow and is expected to be completed by the end of 2011. We recommend that the Company implement procedures to ensure that applicable State eligibility requirements are met for all applicants and properly documented in the interim.

Lack of Policy and Procedures Related to Capital Asset Impairment

During our audit procedures, we noted that the Company did not have a formal process in place to evaluate capital asset impairment.

To strengthen internal controls, we recommend that management implement policies and procedures to ensure that fixed assets reflect the existing business circumstances and economic conditions in accordance with the accounting policies being used. Furthermore, management should periodically review the valuations and/or realizability of fixed assets to identify permanent impairments and to properly record such.

Lack of Inventory for and Policy and Procedures Related to Capital Assets

During our audit procedures, we noted that the Company did not have an inventory of all property owned or a formal process in place to explain the steps that should be followed in tagging items, which items should be tagged, how the inventory should be catalogued, who is responsible for maintaining the property inventory, how often it is required to be updated, how additions and deletion should be treated and other matters required pursuant to Title 34 part VII, Chapter 3 of the Louisiana Administrative Code.

We recommend that management implement procedures to ensure that assets are tagged and inventoried as required by the state so the Company is in compliance with Title 34 of the State Administrative Code. Furthermore, to strengthen internal controls, we recommend that the Company develop policies to document the procedures that should be followed and the person(s) designed to be responsible to complete the procedures and review the procedures so that a clear record exist as to the existence and economic condition of assets held by the Company. Such procedures will reduce the likelihood of theft and fraud and strength the Company's control structure.

Lack of Controls Over Administering and Monitoring User Access

User Administration - CRI evaluated if procedures exist and are followed to ensure timely action relating to requesting, establishing, issuing, suspending, modifying, and closing user accounts to include:

- New user accounts in the network, application, and database environments are set up in response to properly authorized requests from management.
- When user access rights or modifications (due to job transfers or other reasons) occur, the access rights of these users are reviewed in order to remove access rights that are no longer needed. Additional access rights are granted in response to properly authorized requests from management.

Requesting/Issuing/Establishing/Modifying Users- (Network and applications) a sample of 5 new users was selected from a population of 10. All users had documentation completed by HR.

Suspending/ Removing Users- 6 Users were terminated from 1-1-2009 to present. All users had requests for termination.

Termination of Users- User access rights are removed or suspended in a timely manner when employees are terminated. Standards exist to define timeliness requirements for various situations (i.e., voluntary or involuntary termination). The current system does not allow a removal time calculation to be made. Best practices are removal within 24 hours.

We recommend the Company document the flow and approvals for requesting, establishing, issuing, suspending, modifying, and closing user accounts is critical to controlling access to computer systems. A well documented process initiated by HR decreases the risk of error in approvals as well as prompt implementation of changes to user access. HR should provide initiation and completion verification and act as a central point of checks and balances for completion of these tasks. While Citizens has implemented access documentation through HR the documentation should be improved to evaluate all access controls and user rights. The documentation should be improved to properly identify *all* systems access required and roles requested and approved. In addition dates and initials to provide information to properly audit terminations and removal times should be added.

CRI reviewed access controls for the following systems:

System	Comments																		
FiServ-Pro Financials	The system will allow passwords of 1 character. In addition the program does not require regular password changes. This should be considered a high risk and reviewed by inquiry of each user to ensure proper password complexity is used and passwords are changed every 90 days.																		
LPMS (Set for Retirement)	<p>LPMS uses both role based and "job title" base to segregate user access. User access is granted by LPMS by request of LCPIC. The system is set for retirement in 2010. A SAS70 has not been completed by LPMS for this system. Due to system retirement it will be difficult to have the vendor complete a SAS70 at this time. LPMS access controls can only be tested using an "as of" date. The system access controls cannot be properly evaluated for the 2009 year. As a result the financial auditors will evaluate manual compensating controls in these areas. The LPMS access controls were evaluated in May 2010 by CRI. Although the system is set for retirement it will be in use until the EPIC system is fully operational. We have informed Management controls should be implemented in all systems going forward to properly maintain and evaluate user access. Current controls in place at ITBD were requested. LCPIC personnel completed a process for removal of rights for all accounts including high risk accounts to provide those rights only to individuals which are required to complete their job functions. We noted the following items which should be addressed by management.</p> <p>High risk access roles - SBS-Consultants- Can approve a check for any amount. All users and all roles with job titles were obtained. We noted seven (7) accounts with this role. Inquires were made as to the validity and need for these accounts. The following information was provided updates are appropriate.</p> <table border="1"> <thead> <tr> <th>Username</th><th>Date added</th><th>Explanation</th></tr> </thead> <tbody> <tr> <td>catloss</td><td>10/20/2008</td><td>This has been deactivated 5/12/2010</td></tr> <tr> <td>CCMelancon</td><td>8/16/2007</td><td>Since all other users were removed LCPIC kept in case a task was not able to be completed by another user. Would be able to verify what task was and assign that task to new role.</td></tr> <tr> <td>crishelpertool</td><td>8/8/2006</td><td>Since all other users were removed LCPIC kept in case a task was not able to be completed by another user. Would be able to verify what task was and assign that task to new role.</td></tr> <tr> <td>ericahelpertool</td><td>1/4/2008</td><td>This role has been changed to Helper Tool 5/12/2010</td></tr> <tr> <td>LPMS_System</td><td>1/4/2008</td><td>lpms_system login needs to stay with the role of "SBS-Consultant" because this user is used for all of the nightly</td></tr> </tbody> </table>	Username	Date added	Explanation	catloss	10/20/2008	This has been deactivated 5/12/2010	CCMelancon	8/16/2007	Since all other users were removed LCPIC kept in case a task was not able to be completed by another user. Would be able to verify what task was and assign that task to new role.	crishelpertool	8/8/2006	Since all other users were removed LCPIC kept in case a task was not able to be completed by another user. Would be able to verify what task was and assign that task to new role.	ericahelpertool	1/4/2008	This role has been changed to Helper Tool 5/12/2010	LPMS_System	1/4/2008	lpms_system login needs to stay with the role of "SBS-Consultant" because this user is used for all of the nightly
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LPMS_System	1/4/2008	lpms_system login needs to stay with the role of "SBS-Consultant" because this user is used for all of the nightly																	

			processing applications such as: Batch Print, Accounting Console and the FTP Transfer process.
	pennyhelpertool	9/26/2005	This role has been changed to Helper Tool 5/12/2010
	apbackup	1/4/2008	This role has been requested to deactivate 5/13/2010
<p>Claims Manager (Service Provider Claims Managers) Can approve checks that are less than \$25,000 and the cumulative amount paid on the claim is less than \$25,000</p> <p>A listing of all service provider employees with access to LPMS was submitted to each service provider for review to ensure all users are current and active employees.</p> <p>First Premium-1 user has a "Claims Manager" right that is no longer with the company. Two generic users have "Claims Manager" rights. These users should be removed.</p> <p>Note: 22 of 88 users were no longer with the company but had minimal rights. These users should be removed.</p> <p>24 generic user names are present. Generic users should be used with great caution and removed if not necessary.</p> <p>Bankers- 3 users have "Claims Manager" rights that are no longer with the company. Two generic users have "Claims Manager" rights. These users should be removed.</p> <p>Note: 51 of 134 users were no longer with the company but had minimal rights. These users should be removed.</p> <p>37 generic user names are present. Generic users should be used with great caution and removed if not necessary.</p> <p>"Data Entry" can request claim checks but must be approved by either the Claims Manager or Citizens Claims manger depending on the amount of the request and the total amount paid on the claim to date.</p> <p>Review of high risk user titles - "Citizens Claim Manager" and "Citizens Assistant Claims Manager"- Can approve checks that are greater than \$25,000.00 but less than \$100,000. Can approve checks for claims that have a cumulative paid amount on the claim greater than \$25,000. Can approve claim checks that do not have a coverage associated with the payment.</p> <p>One user has "Citizens Claim Manager" title and one user has "Citizens Assistant Claims Manger" title. Per Management these users are appropriate.</p>			
Image Write	Image Write will allow blank passwords. This system should be scanned for the existence of PII data and properly secured if PII data is contained.		

DataMart	Datamart access is controlled through active directory security. Reference the active directory information.
Wire/ACH	User lists were obtained directly from Regions ITreasury and Capitol One. All users are current employees and access is appropriate per Jules Nunn. ITreasury requires a password of at least 6 characters and Capitol One requires at least 6 characters of which 1 must be a number.
Active Directory	Account Policies Min password len: 8 chars Max password age: 91 days Min password age: 90 days Password history: 0 passwords-This should be changed to at least 5 Do not force logoff when logon hours expire Lockout after 5 bad logon attempts Reset bad logon count after 15 minutes-This should be increased to at least 24 hours. Lockout duration: 15 minutes Complexity-Enabled
ORBS	ORBS access is controlled through active directory. Users were examined and are satisfactory.

The Company is in the process of establishing regular user access reviews however this process is not complete. Discussions were held with management to evaluate access review procedures and schedules. Management should continue to implement and improve these reviews.

Lack of Monitoring Over Service Providers - IT Vendors

The Company relies heavily on the expertise of service providers to accomplish IT functions. These vendors have been identified below. Management is aware of the requirements for current contracts and controls evaluation of the IT vendors. Discussions with IT management were conducted for SAS 70, SSAE 16 and agreed upon procedures (AUP) report requirements from vendors. The following vendor documents were obtained to evaluate the current status of vendor contracts and documentation. All IT vendors are currently under contract.

Vendor	Service or product provided	Purpose	Due Diligence	SAS 70/AUP	Initial contract date	Accepted by
VenYu	Data facility	Offsite processing	Per RFP	4/28/2010	2/19/2008	J.J. Wortman
Iron Mountain	Data Storage	Offsite backup storage				
IT By Design	LPMS ORBS software code and support	Software support and coding for LPMS			1/1/2010	J.J. Wortman
i4	Data Mart code and support	Software reporting tool for LPMS	Prior contracts with LCPIIC 12/06/2007		4/1/2010	J.J. Wortman
FiServ	Accounting package	GL,AP,AR,	re-assigned to LCPIIC on 6/26/08		3/29/2004	Paige Harper

West Point Underwriting, Inc.	Software and Conversion Support	Purchase application software for Policy and Claims	RFP		4/8/2009	J.J. Wortman
A T & T	Communications	Voice and Data including TSP Codes			8/18/2008	J.J. Wortman
Xactware	Claims Data Management	Manage claims through independent adjusters			7/30/2009	J.J. Wortman
ChoicePoint/Le xusNexus	Electronic Notices	Notices to Mortgagee and Additional Insured			9/14/2009	J.J. Wortman

We recommend the Company obtain vendor documentation for controls evaluation such as a SAS70 for Iron Mountain, West Point Underwriting and i4. Furthermore, management should note the AICPA has released guidance for SSAE 16 which should be used for vendor control evaluations of IT processes. While a SAS70 has become a standard for controls evaluation for financial reporting the SSAE 16 allows controls evaluations for those controls not related to financial reporting but may have significant impact for organizations relying on controls which may not be in scope for a SAS 70. General IT controls evaluation should be requested from Iron Mountain. A request for SSAE 16 to evaluate software development controls for West Point Underwriting and i4 should also be requested. In the absence of the SSAE 16 LCPIIC should define and obtain a list of controls used by West Point Underwriting and i4 to maintain proper software development.

Inadequate Controls for Securing and Monitoring Systems

Perimeter security is conducted and maintained by Venyu. Currently there is no regular monitoring of the external firewall by Company personnel. Company management places reliance on Venyu to notify them of security events however, Venyu is not under contract to provide monitoring services. Venyu will, however, notify the Company in the event of an observed intrusion. This does not provide adequate monitoring and response to external threats.

We recommend that the Company either enters into a contract with a third party for security monitoring of external connections or begin to monitor this in house.

The Company uses Trend-Micro for anti-virus protection. The anti-virus management console was reviewed for current definitions pull and push. A sample of 10 workstations was selected to review anti-virus settings. All samples have current virus definitions.

We recommend, as an improvement to external defense strategies, that the company should consider conducting a vulnerability and penetration test completed by an independent third party to evaluate all external interfaces.

User access controls are defined above in "Lack of Controls Over Administering and Monitoring User Access". The Company's IT security policies are in development and require approval. Use of shared

user ids and passwords are prohibited in the reviewed draft policy to be presented for approval. During discussions with users it was noted that use of shared usernames and passwords are informally prohibited.

We recommend that new systems not require the use of personal private data (PII). However, a review of LPMS revealed the system contains legacy PII data. The Company should either remove all PII data if not required or take measures to protect such data per best practices including protection of PII data in storage, use or transit.

Remote access users are identified and appropriately restricted using Active Directory. However, reconciliations are not formalized.

We recommend that the VPN should be used to establish all remote sessions. The Company should formalize review of all remote access semi-annually. In addition, the Company would benefit greatly through implementing a formalized IT access segregation of duties process. The Company has unique challenges of access control for external service providers, IT support companies, and internal users. A matrix of access requirements, users and review processes/schedules would help ensure "least privilege access" is maintained.

Monitoring logs of LPMS is not conducted on a regular basis. However these logs are available in the event of an issue or problem. FiServ is not currently capable of tracking user logins.

The Company should develop, disseminate, and periodically review and update a formal documented security awareness and training program that addresses purpose, scope, roles, responsibilities, and compliance. In addition to the general data security training and awareness, programs can also be developed for particular applications.

Training should be conducted to include (but not limited to):

- The organization's vision and mission relating to the protection of information resources, including the importance of information security and the ways in which it forms part of critical asset protection.
- Applicable laws, regulations, policies, and procedures.
- Data classification requirements.
- Data life cycle security considerations, including limiting the data that is collected, accessed, or displayed to that which is essential for the function to be performed, data protection during usage, processing, and storage, and effective methods of disposal.
- An overview of risks and safeguards.
- Roles and responsibilities, including clear guidelines on the correct use of the organization's information and what each particular group of users is authorized to access.
- The implication of security incidents to both the organization and the individual.
- Reporting requirements and procedures for unauthorized access, disclosure, or modification of information.
- An overview of the data security incident management program, including workflow and other relevant features.

Training can be conducted in a classroom setting, remotely, and periodic issuance of security awareness literature. Training and awareness material can also be made available on internal networks that can be accessed by employees.

Lack of an Internal Audit Function

During the first quarter 2010, the Company began development of an internal audit function which was implemented during the second quarter 2010. Testing will be completed in all significant areas on a periodic basis and results reported directly to the Company's audit committee.

However, for the year under audit, the Company did not have an effective internal audit function in place to examine, evaluate, and report on its internal controls, including information systems, and to evaluate compliance with the policies and procedures that comprise internal controls. Furthermore, the prevention and detection of fraud through the performance of internal audit tests and procedures was not a priority.

The Company should continue to improve its operations through the development of formal written policies and procedures which includes an emphasis on a control environment with an atmosphere in which people conduct their activities and carry out their responsibilities based on a tone set by management to be control conscious people.

Lack of Controls over Changes to Master Vendor File

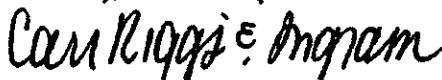
During our audit procedures, we noted that an employee who was responsible for entering invoices into the Company's system for payment generation also has the authority to make additions and changes to vendor information in the master vendor file. As a result, fictitious vendors could be established and erroneously paid by one employee. When we inquired of management, they were fully aware and explained that this person worked in another department but had been given dual authority for a short period of time so that they could cross-train on the account payables system. Subsequently, all authority into this system was removed.

To strengthen internal controls, we recommend that management develop a more formalized approach which includes a process where requests to make additions to or change vendor master file data are logged; the log is reviewed to ensure that all requested changes are approved by management and processed timely. This process will help to ensure that all changes made to the master file are valid. Management should also review and approve all changes on a scheduled basis. This would catch any unauthorized processing of information and changes to systems.

As part of our audit, we reviewed the status of prior findings as reported to us by management. The status of prior findings is summarized in attachment A to this letter.

This communication is intended solely for the information and use of the Board of Governors, Louisiana Legislature, management, others within the organization, and the Louisiana Department of Insurance and is not intended to be and should not be used by anyone other than these specified parties.

Yours truly,



Carr, Riggs & Ingram, LLC

**LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION
SUMMARY STATUS OF PRIOR FINDINGS
ATTACHMENT A**

Finding 2008-01

Lack of Controls Over Administering and Monitoring User Access

Louisiana Citizens Property Insurance Corporation ("the Company") granted employees and non-employees excessive, inappropriate access to the Louisiana Plans Management System (LPMS) and Fiserv, which allowed users the access to make changes to critical data, exposing the Company to potential error and fraud. LPMS is used for maintaining insurance policies and claims processing. Fiserv is the general ledger system used for disbursements and financial statement preparation. The Company lacked proper controls over the granting and termination of user IDs in its systems, lacked proper segregation of duties, and did not properly review and monitor accesses granted.

LPMS

As of May 2009, 137 active user IDs were granted "Consultants-SBS" role in the LPMS database, allowing users the ability to make changes to any data in the system, including, but not limited to, policies, agents, claims, claim payments, percentage commissions paid to

Of the 137 users with IDs with these broad access rights:

- 77 belonged to Company employees;
- 15 could not initially be identified by the Company; however, after several months the Company identified seven (two Property Insurance Association of Louisiana (PIAL) employees, two PIAL employees who terminated, two Department of Insurance employees, and an American Insurance Association Board member) and labeled the other eight IDs as former temporary employees of the Company;
- 22 were generic IDs;
- 14 belonged to the service providers Bankers Insurance Group and First Premium Insurance Group who are contractors assigned policies for underwriting and claims administration;
- 7 belonged to employees of PIAL, three of whom have terminated employment with PIAL; and
- 2 belonged to terminated employees of the Company. At the test date, one employee had been terminated for nine months and the other for 12 months.

In addition, employees and nonemployees with LPMS user IDs were assigned the "SBS Consultants" job title that enables the user to approve claims over \$25,000 using the LPMS claim approval screen. These included four unidentified users; one employee who does not have a valid business need; five generic user IDs; one terminated PIAL employee; and one service provider user.

We could not determine who had access to one generic user ID titled "Mail Clerk Claims" that was inappropriately assigned the "Claims Manager" job title and can approve claim payments totaling \$25,000 or less and approve all loss adjustment expenses. This user ID has existed since January 2006.

Fiserv

Within the Company's accounting section, job functions assigned and accesses granted to employees did not appropriately segregate the functions of authorization, data entry, generation, and review of disbursements. Because of excessive access granted to the Fiserv application,

users were allowed access to make unauthorized changes to accounting data that included, but were not limited to, payee names, addresses, disbursement amounts, and journal entries. Of the 18 active user IDs:

- 14 had full administrative access allowing any change in the Fiserv system and 13 of the 14 also had full access to LPMS through the Consultants-SBS role, and
- 4 had profiles with rights to change vendors, claimants, and disbursement data and three of the four also had full access to LPMS through the Consultants-SBS role.

In addition, all 13 employees in the accounting section plus seven additional users had access to a shared directory on the network that gave them the ability to alter bank reconciliations and unencrypted batch files used to post payments and process disbursements.

The Company's management allowed numerous users to work around LPMS malfunctions in the period surrounding hurricanes Katrina and Rita in 2005 by assigning the Consultants-SBS role, and thereafter continued to grant this access because of a lack of formal procedures and a limited technical knowledge of LPMS. The Company has not adequately defined its security administrator function and has no formal written security policies and procedures for granting user IDs. In addition, the Company does not have an adequate definition of authority and responsibility to use as a basis for defining security permissions and roles and for designing forms to be used to approve access rights.

Status of Finding 2008-01 – Partially Resolved

LPMS uses both role based and "job title" base to segregate user access. User access is granted by LPMS by request of the Company. The system is set for retirement in 2010. A SAS70 has not been completed by LPMS for this system. Due to system retirement it will be difficult to have the vendor complete a SAS70 at this time. LPMS access controls can only be tested using an "as of" date. The system access controls cannot be properly evaluated for the 2009 year. As a result the financial auditors will evaluate manual compensating controls in these areas. The LPMS access controls were evaluated in May 2010 by Carr, Riggs and Ingram. Although the system is set for retirement it will be in use until the EPIC system is fully operational. We have informed Management controls should be implemented in all systems going forward to properly maintain and evaluate user access. Current controls in place at ITBD were requested. Company personnel completed a process for removal of rights for all accounts including high risk accounts to provide those rights only to individuals which are required to complete their job functions. We noted the following items which should be addressed by Company management.

High risk access roles - SBS-Consultants- Can approve a check for any amount. All users and all roles with job titles were obtained.

We noted seven (7) accounts with this role. Inquires were made as to the validity and need for these accounts. The following information was provided updates are appropriate.

Username	Date added	Explanation
catloss	10/20/2008	This has been deactivated 5/12/2010
CCMelancon	8/16/2007	Since all other users were removed, the Company kept in case a task was not able to be completed by another user. Would be able to verify what task was and assign that task to new role.
crishelpertool	8/8/2006	Since all other users were removed the Company kept in case a task was

		not able to be completed by another user. Would be able to verify what task was and assign that task to new role.
ericahelpertool	1/4/2008	This role has been changed to Helper Tool 5/12/2010
LPMS_System	1/4/2008	lpms_system login needs to stay with the role of "SBS-Consultant" because this user is used for all of the nightly processing applications such as: Batch Print, Accounting Console and the FTP Transfer process.
pennyhelpertool	9/26/2005	This role has been changed to Helper Tool 5/12/2010
apbackup	1/4/2008	This role has been requested to deactivate 5/13/2010

Claims Manager (Service Provider Claims Managers) Can approve checks that are less than \$25,000 and the cumulative amount paid on the claim is less than \$25,000

A listing of all service provider employees with access to LPMS was submitted to each service provider for review to ensure all users are current and active employees.

First Premium-1 user has a "Claims Manager" right that is no longer with the company. Two generic users have "Claims Manager" rights. These users should be removed.

22 of 88 users were no longer with the company but had minimal rights. These users should be removed.

24 generic user names are present. Generic users should be used with great caution and removed if not necessary.

Bankers- 3 users have "Claims Manager" rights that are no longer with the company. Two generic users have "Claims Manager" rights. These users should be removed.

51 of 134 users were no longer with the company but had minimal rights. These users should be removed.

37 generic user names are present. Generic users should be used with great caution and removed if not necessary.

"Data Entry" can request claim checks but must be approved by either the Claims Manager or Citizens Claims manger depending on the amount of the request and the total amount paid on the claim to date.

Review of high risk user titles - "Citizens Claim Manager" and "Citizens Assistant Claims Manager"-
Can approve checks that are greater than \$25,000.00 but less than \$100,000.
Can approve checks for claims that have a cumulative paid amount on the claim greater than \$25,000.
Can approve claim checks that do not have a coverage associated with the payment.

One user has "Citizens Claim Manager" title and one user has "Citizens Assistant Claims Manger" title. Per Management these users are appropriate.

FiServ-Pro Financials:

The system will allow passwords of 1 character. In addition the program does not require regular password changes. This should be considered a high risk and reviewed by inquiry of each user to ensure proper password complexity is used and passwords are changed every 90 days.

Finding 2008-02
Lack of Monitoring Over Service Providers

The Company did not perform adequate monitoring or internal audits on the procedures, controls, and transactions processed at the three service providers that it used to perform insurance policy administration and the related claims services for policyholders. The Company also did not obtain Type II, Statement on Auditing Standards (SAS) 70 reports on its service providers. Good internal controls require an entity to monitor, review, tests and evaluate the transactions controlled or affected by its service providers to ensure data integrity, completeness, and accuracy. One means of gaining assurance on the controls within a service organization is through Type II, SAS 70 reports.

The Company's employees were not required by internal policy to review transactions in amounts less than the Service Provider Authority thresholds, which include general claims under \$25,000 and catastrophic claims up to \$75,000. The claims that were less than the service provider's authority threshold comprised 60,547 out of 61,229 claims (99%) in 2008. The lack of review and approval of these transactions by the Company's employees increases the risk that there may be errors or fraudulent activity related to claims loss payments within the service provider's authority threshold amounts and could result in misstatements to the financial statements. This risk emphasizes the need for monitoring of the service centers.

Although the contracts with the service providers do not require Type II, SAS 70 reports, the contracts do provide that the Company can perform operational audits at the service centers. The Company did not conduct operational audits of the service centers in 2008. Although the Company did contract for some review services in 2009 after the fiscal year under audit, those procedures were not an adequate substitute for obtaining Type II, SAS 70 reports on the service providers.

The Company placed its faith in the performance of the service providers without externally monitoring that performance. Failure to perform sufficient operational audits or to obtain SAS 70, Type II reports on each of its service providers results in the inability to ensure that procedures and controls are being applied in accordance with the Company's intentions and regulations and increases the risk that contract terms are not being followed, which could result in errors, overpayments, financial misstatements, or fraud.

Status of Finding 2008-02 – Partially Resolved

All service providers have agreed to obtain SAS 70 Type II reports, which are anticipated to be completed by December 31, 2010 and the Company has determined that similar reports will be required for all future service providers associated with claims processing and policy administration. Furthermore, the Company has implemented procedures to ensure adequate monitoring of activities conducted by service providers.

Finding 2008-03
Inadequate Loss Reserve Development Process

The Company does not have an adequate process to develop loss and loss adjustment expense (LAE) reserve liabilities. The Company is required to estimate the ultimate cost of settling insurance claims, including costs related to claims that were incurred but not reported, using past experience adjusted for current trends. Management is responsible for its estimates and the implementation of controls to ensure that the data used in deriving these estimates are complete and accurate. The Company engages an outside actuary to assist in the estimation of the loss and LAE reserve liabilities based on data provided by the Company.

Although an unfavorable judgment of \$95 million was issued to the Company on March 20, 2009, on a class action suit related to prior years' hurricane claims, there was no evidence that the Company made any provision in the reserve amount for this case or other pending class action suits and mass joinders. The appointed actuary's Statement of Actuarial Opinion as of December 31, 2008, noted that the loss reserves carried by the Company does not include provision for possible unfavorable outcomes concerning four pending class action suits and 16 mass joinders. The actuary's opinion states, in part, "The scope of my opinion does not include any provisions for these (or possible future) class action suits and mass joinders. Therefore, my opinion is qualified in this regard." In addition, during tests of loss claims and loss reserves, auditors did not find any items within the recorded reserves tested that made provision for amounts related to these class action suits and mass joinders.

Audit procedures identified various errors and deficiencies in the data that was relied on by the appointed actuary to develop the estimate of reserves at December 31, 2008, as follows:

1. Case basis loss reserves related to system claims do not appear to include all appropriate amounts at year-end. Auditors ran a query on loss payments issued in the first three months of 2009 related to claims with (1) a loss occurrence date prior to the end of 2008; (2) a loss report date prior to the end of 2008; and (3) no reserve amount in the outstanding claim register. This procedure identified 4,257 payments totaling approximately \$23 million. A review of the transactions identified errors indicating that case basis loss reserves did not include all appropriate claims at December 31, 2008. Specific errors included:
 - Reserves associated with several claims appear to have been closed out as a result of advance (partial) payments coded as "final" payments in the claims system.
 - Reserves were not reestablished for claims with payments that were issued and voided prior to year-end and were reissued subsequent to year-end.
 - Reserve balances were not established for certain claims although documentation in the claim file at December 31, 2008, indicated that the amount of the loss was known.
 - Amounts related to off-system, manually processed claims were excluded from direct case basis loss reserves for all accident years. At December 31, 2008, these amounts were approximately \$2.8 million for case basis loss reserves and approximately \$60,000 for LAE reserves.
2. Case basis loss reserve balances included approximately \$1.4 million on claims that were closed and had no loss reserves as of December 31, 2008.
3. The Company did not appropriately classify paid LAE and LAE case reserves as defense and cost containment (DCC) expenses or adjusting and other (A&O) in accordance with Statement of Statutory Accounting Principle (SSAP) No. 55. As a result, DCC paid and case basis reserve data relied on by the appointed actuary is inaccurate.
4. During a review of case reserves related to litigated claims, the following discrepancies between reserves recorded by the Company and the value of the loss represented to the auditors by the Company's outside legal counsel were identified:
 - One claim with a recorded reserve at December 31, 2008, of \$220,000 was settled in 2007 and therefore should not have had a reserve balance at December 31, 2008.
 - Two claims with recorded reserves of \$16,000 had probable outcomes estimated in the range of \$700,000 and \$1.3 million based on information from legal counsel.

- Seven claims with total recorded reserves at December 31, 2008, of approximately \$2 million were settled or tentatively settled in 2009 for approximately \$334,000. The Company's recorded reserves for these seven cases ranged from \$206,000 to \$450,000 per claim, and the settlement (or tentative settlement) amounts ranged from \$5,000 to \$130,000 per claim.
- Four claims with total recorded reserves of \$1.2 million had probable outcomes estimated in the range of \$290,000 to \$400,000 based on information from legal counsel.

These conditions are the result of inadequacies in the Company's information systems and inadequate procedures to ensure that loss information is complete and accurate. Furthermore, the Company is not timely updating case reserves to reflect the best available information.

Failure to maintain accurate and complete information related to losses and loss adjustment expenses hampers the estimation process and increases the risk of material misstatement of liabilities and expenses reported in the financial statements.

Status of Finding 2008-03 – Unresolved

Although significant progress had been made in this area by year end and subsequent to December 31, 2009, including development and implementation of monitoring procedures over claims processed by outside services providers as well as litigation claims, our procedures noted certain exceptions during our testing which included claims processed throughout the year. See current year findings 2009-03 above.

Finding 2008-04

Noncompliance with State Eligibility Requirements

The Company did not follow state law to ensure that all applicants were eligible to be insured by Louisiana Revised Statute (R.S.) 22:2302(A) which provides that any person having an insurable interest in insurable property and who has been denied coverage by one or more insurers authorized to write property insurance in this state is eligible to apply for insurance through the Company directly or through a representative. R.S. 22:2302(A) further provides that every application form shall require that the applicant disclose each insurance carrier who denied property insurance coverage to the applicant.

During our test of direct written premiums, 35 applications for policies written in 2008 were reviewed. Of these 35 applications, 11(97%) did not disclose on the application that the applicant was denied coverage or list each insurance carrier who denied property insurance coverage to the applicant. "No" was checked on the applications for the question "Has insurance been cancelled, declined, or non-renewed in the voluntary market?"

Management expressed that it did not have the means to implement a control to ensure compliance with this provision. Failure to ensure that all policyholders are eligible to be insured by the Company causes it to be in noncompliance with state law and could result in policies being issued to ineligible applicants, which could lead to payment of losses to an ineligible insured. This also increases the risk of misstatement of premiums earned and claim losses on the financial statements. In addition, the legislation creating the Company explicitly states that the legislature intends for it to work to reduce the number of policy holders until the Company is no longer needed. If the Company issues coverage to those who could get coverage elsewhere, then legislative intent for the Company to be the insurer of last resort would not be met.

Management should ensure that policies are issued only to those applicants whose application information demonstrates eligibility for coverage as prescribed by state law. Management concurred with the finding and provided that the new policy management system that will be installed in the spring of 2010 will prohibit the issuance of new policies to property owners who have not been denied coverage by another company.

Status of Finding 2008-04 – Partially Resolved

The new EPIC system mentioned above was implemented in March of 2010 and requires a decline from another insurance company in order to complete an application for the Company's policy. The Company expects to have all personal line policies, which is the majority of the policies written by the Company, fully transitioned to the EPIC system by April 1, 2011. The commercial line conversion will follow and is expected to be completed by the end of 2011. See current year Finding 2009-05 above.

**Finding 2008-05
Uncertainty in Premiums Receivable**

The Company did not adequately support premiums receivable. The Company could not provide an accurate and complete aging of premiums receivable, and the results of our tests indicate an uncertainty of the premiums receivable (uncollected premiums) balance at December 31, 2008. Good business practices require that accurate and complete financial records be maintained to ensure that the amounts recorded in the financial statements are materially correct.

The Company uses its LPMS to process and record premium transactions. However, because of the limitations and unreliability of LPMS, The Company contracted with a computer consultant to design the Louisiana Citizens Data Mart (Datamart) as a method of obtaining data from LPMS. Datamart reports are used to create the manual general ledger entries to generate financial reports. The aging of uncollected premiums was also determined using the Datamart. Management reported admitted premiums receivable of approximately \$23.4 million.

During our testing of admitted uncollected premiums at December 31, 2008, 24 transactions totaling \$413,313 were examined. For seven of 24 (29%) transactions tested, the premium balance outstanding at December 31, 2008, was overstated in total by \$309,508. Upon further evaluation of the exceptions, the following deficiencies were noted:

- In five exceptions noted above, all or part of the premium payments totaling \$225,636 were removed (suppressed) from the receivables balance. While generating the aging of premiums receivable, the computer consultant erroneously removed premium payments thought to be duplicate payments. A total of \$960,345 in premiums payments were removed from the premiums receivable balance, which resulted in an overstatement to premiums receivable of \$960,345. The monies were appropriately deposited into the Company's accounts.
- In two exceptions, the premium balance in the aging report was incorrect and there should have been no balance (zero) at December 31, 2008. The computer consultant generates the aging report by pulling the balance from the LPMS policy balance table. When a change is made to the premium amount via an endorsement, LPMS does not process the amounts correctly in the policy balance table, which Datamart uses to create the aging report. Auditors could not determine why LPMS is calculating the amounts incorrectly in the table and therefore cannot determine the extent of the misstatement.

- For one exception, the balance in the aging report was incorrect; the balance should have been zero at December 31, 2008. When a renewal policy cancels before the effective date of the policy, the Company refunds the entire premium and fees paid by the applicant. However, for such an event, the emergency assessment fee does not zero out in the LPMS policy balance table, which results in a false receivable in the amount of the emergency assessment fee. In each case, the receivable amount should be zero. Based upon the available information, auditors could not determine the extent of the misstatement.

Failure to maintain an accurate and complete aging of premiums receivable has resulted in an uncertainty of the premiums receivable balance reported on the financial statements at December 31, 2008. This increases the risk of material misstatement of premiums receivable on the financial statements.

Status of Finding 2008-05 – Resolved

Finding 2008-06

Inaccurate and Incomplete Annual Fiscal Report

The Company did not submit an accurate and complete Annual Fiscal Report (AFR) to the Division of Administration for the fiscal year ended December 31, 2008. As authorized by R.S. 39:79, the commissioner of administration through the Division of Administration's Office of Statewide Reporting and Accounting Policy (OSRAP) prescribes the content and format for the preparation of each entity AFR, which is then used in the compilation of the state's

Comprehensive Annual Financial Report (CAFR) in accordance with accounting principles generally accepted in the United States of America. Good internal control includes establishing a process to ensure that these financial statements are accurately prepared and reviewed the Company's AFR submitted to OSRAP in September 2009 included the following errors and omissions:

- Assets and liabilities were understated by \$76,227,692 and had to be increased to report reinsurance receivable as an asset as required by generally accepted accounting principles, instead of netting it against liabilities.
- Assets and liabilities were overstated by \$47,234,072 as the Company incorrectly included inter-fund balances due to and from other funds. These inter-company accounts should have been eliminated from the combined financial statements.
- Assets and liabilities were overstated by \$7,847,305 because of an erroneous adjustment made by the Company as part of a prior period adjustment.
- Current liabilities were overstated by \$6,668,920 as the Company recorded current liabilities for collections of emergency assessments on its own policies. In addition, current assets were overstated by \$2,774,363 and revenue was understated by \$3,894,557 as the Company failed to reduce receivables and increase revenues for the emergency assessment collections.
- Assets and revenues were overstated by \$960,344 as the Company's computer consultant erroneously removed premium payments thought to be duplicate payments causing the payments not to be reflected in the financial statements.
- The Company did not report \$48,150,000 for the current portion of the bonded debt as current payable. The entire amount of bonded debt was reported as a long-term liability.

- The Company failed to report net assets as restricted for debt service of \$74,322,314 and invested in capital assets net of related debt of \$5,161,302. These amounts were incorrectly included in the unrestricted net asset amount.
- Revenues were overstated by \$7,847,305 as the Company included a transaction in prior period adjustments that should have netted to zero, but instead created \$7,847,305 current year revenue. In addition, the Company included an additional \$4,161,064 prior period adjustment that was in error. The Company incorrectly included a line item on its operating statement for prior period surplus adjustments, which should have restated the beginning net assets account balance.
- The account "Net assets at beginning of the year, restated" was understated by \$14,887,127 as the Company recorded transactions that affected beginning net assets as change in allowance for doubtful accounts and prior period surplus adjustments.
- The Company recorded \$6,677,528 separately, as change in allowance for doubtful accounts, instead of netting it against premiums earned.
- Prior period adjustments were not disclosed in the prior period adjustments note of the AFR (note AA) but were instead described in the accounting changes note of the AFR (note N).
- Operating revenues of \$7,924,541 were reported as non-operating revenues.
- Operating revenues should have reported premiums earned of \$282,311,752, less premiums ceded of \$96,549,785. Instead the Company reported net premiums written (direct less ceded) of \$162,135,619 and changes in unearned premiums (direct less ceded) of \$23,626,348.
- The Company recorded a Service Provider Fee payable of \$6,548,606 separately, instead of allocating the portion related to unpaid loss adjustment expenses to the loss and loss adjustment expense liability and the portion related to unpaid underwriting expenses to the accrued expenses, taxes, licenses, and fees liability.
- The Company's Statement of Cash Flows included numerous adjustments; did not use the correct amount of operating loss, which should have agreed to the amount reported on the Statement of Revenues, Expenses, and Changes in Net Assets, in the reconciliation of operating loss to net cash used by operating activities; and reported five amounts totaling \$2,667,349 as noncash activities for items that were cash transactions.

In addition, to these errors noted, two other areas of concern were identified and are described as follows:

- The Company did not verify the completeness and accuracy of premium and policy data during 2008. As noted in the prior auditor's fiscal year 2007 audit finding titled "Premiums & Claims," the Company did not have a testing, balancing, and reconciliation function in place for the premium and claims cycles. The Company did not use the Operational Reporting and Balancing System (ORBS) to independently balance and reconcile data until June 2009, after the Company's statutory financial statements had been prepared, and approximately six months after the end of the year.
- The Company did not correctly account for the financing arrangements on the settlement of a legal claim during 2008. The December 31, 2008, financial statements include a current (short-term) receivable for \$15,000,000, which is not correctly classified and reported. The recorded receivable has not been received as of December 11, 2009. The Company did not report the settlement funds as amounts held in trust in the custody of the court. The settlement funds (which

include the \$15 million recorded as a receivable) should have been reported as restricted assets held in trust, with off-setting liabilities for the amount of the settlement losses to be paid. The Company did not recognize the activity of the court during the year, if any, which affected the balance of the settlement funds at December 31, 2008. If funds, such as the \$15 million the Company recognized as a receivable, would have appropriately reduced the unfavorable outcome to the Company, such transaction should have been recorded as a reduction in the payable of the funds in trust, not as a current receivable.

The Company's personnel made miscalculations, misclassified transactions, excluded transactions, incorrectly adjusted prior year amounts, and used inaccurate data in their preparation of the financial statements and the notes to the financial statements. In addition, the supervisory review process was not effective in identifying the errors and/or omissions in the current and long-term claims liabilities and related notes to the financial statements. Failure to submit an accurate AFR can delay the compilation, issuance, and accuracy of the state's CAFR. Furthermore, misstatements from errors or omissions may occur and remain undetected.

The Company's management should ensure that its AFR is properly prepared and should review the financial information and note disclosures in its AFR to identify and correct errors before submitting it to OSRAP and the legislative auditor.

Status of Finding 2008-06 – Resolved

Finding 2008-07

December 2008 Rate-Filing Did Not Comply With State Law

The Company's December 2008 rate-filing did not comply with all requirements in State law. R.S. 22:2303 prescribes the requirements for the board's role in rate setting; the commissioner of insurance's role in rate-setting; the frequency of rate changes; the noncompetitive nature of the rates; and the actuarial requirements of the rates. The Company's rates are not intended to compete with private insurance company rates and must be at least 10% higher than those of the largest insurers with certain exemptions.

As described in the Performance Audit Division's report *Louisiana Citizens Property Insurance Corporation 2008 Rate-Filing* issued May 13, 2009, several aspects of law were not complied with in the December 2008 rate-filing. In October 2008, the Company submitted a rate-filing to the commissioner requesting an overall average rate increase of 13.7%.

The Company paid approximately \$104,000 for an actuarial consultant to assist in its rate determination and used that information in its initial rate-filing. The commissioner notified the Company's management that he would not approve the actuarially indicated rates because of pervasive data integrity issues and other deficiencies in the actuarial analysis. Then, without board approval, the Company's staff submitted a revised rate-filing with a lower average rate increase of 7%, which was then approved by the commissioner and subsequently approved by the board. Since the board did not pre-approve the formulas used by the Company's staff in setting the revised rates, the board did not fulfill its statutory duty of adopting rate-setting formulas before determining rates.

The Company used the market survey conducted by the Department of Insurance in setting its rates without evaluating the responses from the surveyed companies. Consequently, the Company could not have determined if the information was reliable. Because the actuarial information was not used and the survey responses were not evaluated, this process may have inappropriately resulted in noncompetitive rates in noncompliance with state law.

As recommended in the Performance Audit, the Company's board should vote to adopt rate-setting formulas before determining rates. The Company's management should perform its own market survey for future rate-filings or obtain and evaluate survey responses from the Department of Insurance if the department does the survey. The Company should ensure that its rate-filings are actuarially justified as required by law to further ensure they remain noncompetitive. Management concurred in part with our finding noting that it agreed the Company's board needed to review and approve rates and rating formulas before their effective date. The Company's management disagreed that the commissioner disapproved the actuarial data because of "pervasive data integrity issues," and provided that instead, the commissioner's disapproval was that the data was unaudited at that time.

Status of Finding 2008-07-- Resolved

**Finding 2008-08
Noncompliance with Policy Take-Out Program Requirements**

The Company did not comply with the requirements of R.S. 22:2314 regarding the required depopulation of the Company's policies referred to as the Policy Take-Out Program. R.S. 22:2314 provides that the legislature created the Company to operate insurance plans as a residual market for residential and commercial property and intends that the Company work toward the ultimate depopulation of these residual market plans. The Policy Take-Out Program was developed to encourage the depopulation. The statute requires that at least once per calendar year, the Company shall offer policies for removal to the voluntary market in bundles of at least 500 policies, which include both Coastal and FAIR Plan policies. The Company shall include policies in the bundle with geographic and risk characteristics that serve to reduce the exposure of the corporation. Each insurer in Louisiana admitted to write residential or commercial policies who desire to participate must submit a take-out plan to the Company. An insurer shall not be qualified to submit a take-out plan unless that insurer is admitted to write homeowners or commercial insurance in the state of Louisiana. The Company must submit the plans to the Louisiana Department of Insurance (DOI) for review and approval. If the plan is approved by DOI, the Company shall submit the plan to its board. The Company's board shall develop guidelines for the program and file these with the Senate and House committees on Insurance and the commissioner of insurance for approval. The Company conducted two rounds of depopulation in 2008, resulting in seven take-out companies assuming 39,936 of approximately 170,000 policies (23%). Those policies represented approximately \$68 million out of approximately \$260 million in premiums (26%), which followed the policies, also reducing the Company's exposure by an estimated \$9 billion.

In testing compliance with R.S. 22:2314, we identified the following noncompliance and weaknesses:

- The Company offered the total population of in-force policies for take-out but did not bundle them in any way. Instead, the take-out companies were given a database of the policies and allowed to selectively determine the policies each company wanted to assume. The Company then contacted the insurance agents, or producers, to obtain approval to assume those policies. Consequently, The Company failed to comply with specific bundle criteria outlined in the revised statute that included offering policies in bundles that represented the geographical and risk characteristics of its overall population of policies.
- Although 75,683 (45%) of the Company's in-force policies had been selected by take-out companies, only 39,936 (53%) of those policies were actually depopulated. The Company interpreted R.S. 22:23 (Exclusive use of expirations) to mean that a policy could not be depopulated unless authorized by the insurance agent. This interpretation may have caused a lesser number of policies to be depopulated since R.S. 22:2314 has no language requiring an insurance agent's authorization.

- The Company did not collect and submit to DOI any formal take-out plans from interested insurance companies as required by R.S. 22:2314. Compliance with this requirement would have ensured that all seven companies that participated in the two rounds of depopulation would have met the eligibility criteria described in the statute. As a result, one company that was not admitted to write policies in Louisiana and another company that did not have a financial rating were allowed to participate and assume 12,382 (31%) of the 39,936 policies.
- The Company's board did not prepare and submit guidelines for the Take-Out Program to the Senate and House committees on insurance and the commissioner of insurance for approval.

The Company's management believes that there is a statutory conflict between R.S. 22:23 and R.S. 22:2314 and performed the depopulation process by complying with the latter criteria that could be reasonably met while complying with the constraints required by R.S. 22:23. In addition, management noted that compliance with the bundling requirement could have resulted in none of the bundles being selected since each bundle would likely include "unwanted" policies. However, since R.S. 22:2314 is specific legislation related to Louisiana Citizens-only, there is no statutory language in R.S. 22:2314 cross referencing R.S. 22:23, and R.S. 22:2314 is a more recent expression of the legislative will, the latest statute would prevail.

The fiscal impact of the Company's noncompliance with statutory requirements and the resulting effect on premium revenues, claim expenses, and exposure cannot be determined because the number of policies that would have been depopulated if the Company complied with R.S. 22:2314 is unknown. In addition, failure to have take-out plans approved by DOI increases the risk that ineligible companies may be allowed to participate and that these companies could potentially find themselves unable to meet their obligations to the insurance agent or to the policyholder.

Also, failure to submit required Take-Out Program guidelines to the commissioner of insurance and the legislature means that there is no written documentation of approval for the procedures followed by the Company.

Status of Finding 2008-08 – Resolved

Finding 2008-09

Inaccurate Calculation of Emergency Assessments on Premium Changes

The Company did not adjust the emergency assessment surcharge on its policies accurately and in compliance with R.S. 22:2301(E). This statute requires that upon changes to a policy of insurance during the term of the policy that results in an increase or decrease in premium, the emergency assessment is to be adjusted and the amount the insurer shall owe or be owed is to be computed on a pro rata basis for the term of the policy. The Company is required to levy an emergency assessment surcharge on policies written. The amount collected is a uniform, statewide percentage that is determined annually and approved by DOI. For 2008, this was 5% of the total written premiums.

The Company did not update its LPMS until February 2009 to properly reflect the changes in statute that were effective January 1, 2008. The Company's noncompliance with R.S. 22:2301(E) has resulted in policyholders not being charged or refunded emergency assessment amounts on policy premium changes. Because of LPMS limitations, auditors could not determine the amount of the financial misstatement caused by the noncompliance.

Management noted that it became aware mid-2008 that the system was not making the proper emergency assessment adjustments. However, because of the complicated nature of the calculations, the volume of transactions, and the LPMS limitations, management was not able to make any overall retrospective

changes to correct the problem. Because the Company did not update its system in 2008, it placed the burden on the policyholders to discover and seek correction of the emergency assessment amount for their policies.

Management should ensure the calculation and monitoring procedures over emergency assessments result in emergency assessment surcharges that are accurate and in compliance with state law. Management concurred in part to the finding. Management acknowledged that system issues regarding emergency assessments remained in LPMS until corrected in early 2009, but believes the impact of the error is approximately \$220,000.

Status of Finding 2008-09 – Resolved

**Finding 2008-10
Lack of an Internal Audit Function**

The Company did not have an effective internal audit function in place to examine, evaluate, and report on its internal controls, including information systems, and to evaluate compliance with the policies and procedures that comprise internal controls. An effective internal audit function is an independent appraisal activity within an entity for the review of accounting, financial, and other operations. The overall objective is to carry out a program of tests of the financial and operational activities and transactions to provide management with information about the effectiveness (and efficiency) of established accounting and operational policies, procedures and controls, and the extent to which they are being followed. Another objective is the prevention and detection of fraud through the performance of internal audit tests and procedures.

Management did not establish the internal audit function as a priority in 2008. An effective internal audit function could assist the Company in the following areas: (1) developing and testing information technology controls; (2) establishing and testing financial reporting controls; (3) testing compliance with applicable laws and regulations; (4) monitoring service providers; and (5) identifying significant risk areas. Failure to establish an internal audit function increases the risk that the Company's assets are not safeguarded and its policies and procedures are not uniformly applied.

Management should establish an effective internal audit function to ensure that assets are safeguarded and that management's policies, procedures, and controls are applied consistently in accordance with management's intentions. Management concurred in part with the finding.

Management noted that the Company has made progress in developing formal written policies and procedures and internal controls and will continue to examine the benefits of a formal internal audit function.

Status of Finding 2008-10 – Resolved

During the first quarter 2010, the Company began development of an internal audit function which was implemented during the second quarter 2010. Testing will be completed in all significant areas on a periodic basis and results reported directly to the Company's audit committee.

Finding 2008-11
Inadequate Program/System Change Controls

The Company lacks adequate control over changes to its information technology (IT) programs and systems. Good internal controls would require that management monitor change requests to IT system applications and ensure that program changes are properly evaluated, prioritized, authorized, documented, monitored, and tested prior to implementation. In addition, the roles, tasks, and responsibilities of service providers and customers should be defined; logs of all program/system changes should be maintained; and program changes should be moved into production only when approved by management and persons independent of the programmer.

Audit procedures identified the following:

- The Company has not properly segregated duties over changes to programs and systems and has not provided proper oversight and review of these changes. The two vendors who maintain the *LPMS*, *Operational Reporting and Balancing System (ORBS)*, and *Datamart* have the ability to make changes to source code and data and can have those changes moved into production without the Company's knowledge.
- The Company does not have formal documented procedures in place to ensure that all changes to its systems and data are authorized, prioritized, planned, tested, reviewed, and approved prior to moving into the production environment.
- The Company and its vendors do not adequately document reported problems and related system changes and do not close all problems or change orders with documented evidence of resolution.

The Company has not placed sufficient emphasis on the creation, documentation, and enforcement of formal change control procedures. The lack of program/system change controls increases the risk that vendors may make unauthorized, erroneous, malicious, or fraudulent changes to programs or data and move those changes to production without the Company's knowledge; data errors and system downtime may occur because of inadequate planning, testing, and review of changes; and changes to systems, programs, or data may not be known, understood, or reparable by anyone except the person making the change. In addition, without current contractual agreements, the Company is unable to require these vendors to follow formal policies and procedures.

The Company's management should implement procedures to ensure changes made to key programs and systems are appropriately authorized, prioritized, planned, developed, tested, reviewed, approved, and documented. In addition, management should require complete documentation of all reported problems and change requests, monitor the progress, and ensure timely and documented evidence of resolution. Management responded that all program changes are reviewed, tested, and approved before changes are made to the system; there were no unauthorized changes; and the LPMS policy management system does not provide adequate requirements for separation of duties.

Status of Finding 2008-11 – Unresolved

The Company has outsourced coding requirements to third party vendors. As such the vendor controls in this area should be considered critical to the Company's IT operations. This documentation has not been provided by the vendors. The Company should establish controls requirements for each of the vendors involved and conduct its own audits or request the vendor obtain independent third party independent evaluations. This should be accomplished as soon as possible.

The Company's operating system updates will be controlled by Windows Update Server however this process is not yet complete. A haphazard sample of 10 workstations was selected to review update status for security patches. Three of the 10 workstations had not been updated for greater than 60 days and 1 of the 3 was greater than 180 days. The Company should finalize WSUS implementation.

During testing we noted workstations have not been properly updated with the latest patches and updates from Microsoft. The Company should finalize the setup of WSUS to push and monitor operating system updates.

A change and patch management policy is integral to maintain control and configuration changes for not only the core application systems, but the hardware and operating systems they reside on. Stable and managed production environments require that implementation of changes be predictable and repeatable, following a controlled process that is defined, monitored, and enforced. We evaluated program and system change controls for both applications and operating systems.

See current year Finding 2009-02 above.

Finding 2008-12
Inadequate Controls for Securing and Monitoring Systems

The Company has not implemented appropriate controls for securing and monitoring its systems. Good internal controls include policies for application security and availability requirements in response to identified risks; performing security monitoring and periodic testing to minimize and identify security weaknesses and incidents, as well as evaluating their potential impact; and developing and maintaining password requirements that would improve security over its systems.

Audit procedures identified the following weaknesses:

- The Company has not configured its systems to ensure that login requirements for LPMS, Fiserv, and its internal network are adequately complex to help prevent inappropriate access. In addition, the Company has not prohibited the sharing of user IDs and passwords.
- The Company has not formally determined what data should be classified as sensitive and has not protected such data by using accepted security techniques.
- The Company has not appropriately granted and monitored remote access to its internal network. No formal process exists for authorizing remote access, which leads to the lack of an audit trail.
- The Company has not monitored logs within LPMS or Fiserv for unauthorized access to its systems or unauthorized changes to key financial data.
- The Company has not implemented a security awareness program that would inform and train users regarding current information security risks.

The Company's management has not placed sufficient emphasis on information security. The Company has not committed resources to sufficiently manage password changes, monitor its networks, and identify and protect sensitive data. Without proper controls for securing and monitoring its systems, the Company's systems may be susceptible to unauthorized access and changes, as well as theft or destruction of the Company's data without detection. In addition, management may not be able to hold users accountable for unauthorized use of an ID.

The Company's management should require that passwords for all systems meet industry standards for complexity, expiration, and login attempts and disallow the sharing of user IDs. Management should also establish a data classification policy to identify and protect sensitive data; ensure remote access is appropriately authorized and monitored; review access log reports for both Fiserv and LPMS on a regular basis to search for inappropriate or unauthorized changes to data; and implement a security administration function. Management described corrective action plans relating to implementing a new, more complex systems access process, adding levels of security to remote access and publishing formal written IT security policies. Management stated that the Company does not capture sensitive policyholder data. It also expressed that remote access was limited to senior management and technical support.

Status of Finding 2008-12 - Unresolved

Perimeter security is conducted and maintained by Venyu. Currently there is no regular monitoring of the external firewall by Company personnel. The Company places reliance on Venyu to notify the Company of security events however, Venyu is not under contract to provide monitoring services but will notify the Company in the event of an observed intrusion. This does not provide adequate monitoring and response to external threats.

The Company should develop, disseminate, and periodically review and update a formal documented security awareness and training program that addresses purpose, scope, roles, responsibilities, and compliance. In addition to the general data security training and awareness, programs can also be developed for particular applications.

Finding 2008-13

Lack of Contracts for Information Technology Services

The Company did not have contracts in place during 2008 for services rendered by information technology vendors, I.T. By Design (ITBD) and 14 Integrated Services (I4). The Company paid ITBD approximately \$2.5 million and 14 approximately \$558,000 for services between January 2008 and May 2009 without contracts for either vendor.

Good business practices, including those governing information technologies, require contract expenditures to be paid based on the terms and conditions of an approved, written contract. In addition, the roles, responsibilities, and expectations between the contracting parties should be well-defined, and a process should be established to monitor service delivery to ensure that the vendor is meeting current business requirements and that performance is acceptable. Contracts with service organizations should include provisions to require the vendors to provide reports on policies and procedures placed in operation and tests of operating effectiveness in accordance with SAS No. 70 (SAS 70, Type II report).

The Company did not take adequate measures to ensure that information technology service contracts were current and applicable to the ongoing business of the Company after its separation from the Property Insurance Association of Louisiana (PIAL). The lack of contracts with information technology vendors prevents the Company from measuring/monitoring the services provided by the vendors with deliverables included in a defined, agreed-upon service agreement. The lack of an agreement increases the risk that the vendor may make unauthorized changes to systems and data that are not in accordance with a mutually understood agreement. This further allows the vendors to have less accountability and exposes the Company to a lack of recourse if vendors do not perform or perform improperly.

The Company's management should develop written contracts with all of its information technology vendors and include a clause requiring a SAS 70, Type II report when the vendor is a service organization. Management noted that a valid contract was in place in 2008 for 14 and that ITBD was honoring and working with the Company under the original PIAL contract.

Status of Finding 2008-13 – Resolved

**Finding 2008-14
Inadequate Documentation of Information Systems**

The Company does not have adequate current documentation on the design and functions of its critical IT systems. The IT systems were developed by vendors specifically for the Company, including the LPMS, Datamart, and ORBS. In addition, Company management and personnel are critically dependent on vendors to manage, operate, and maintain LPMS and Datamart because of a lack of knowledge transfer between the vendors and the Company. LPMS is the Company's main system for supporting its insurance operations. The Company uses the vendor-developed Datamart as a method of obtaining data from LPMS to develop its manual general ledger entries. ORBS is another vendor-developed system used by the Company to independently balance and reconcile LPMS data to the Datamart.

Although the Company is very dependent on its vendors for its IT systems, the vendors were not required to obtain SAS 70 (service organization) audits to provide the Company with some assurance that adequate controls were in place for those contractors. In fact, management did not have current contracts with these vendors. The primary vendor maintaining LPMS has refused to sign a contract. Efforts to sign a contract with this vendor only appear to have been made after the auditor brought the issue to the Company's attention. The lack of current contracts means that the vendors could abruptly stop providing services and the Company would not be able to manage its own data.

Control and management objectives over IT systems require that software should be developed in accordance with design specifications, development and documentation standards, quality assurance requirements, and approval standards and that a management plan should be implemented and include documentation of the roles, responsibilities, procedures, documentation requirements, appropriate systems documentation, and guidance that is appropriate for personnel with varying levels of skills and experience. Also, critical reliance on vendors for basic system knowledge should be minimized.

The Company's staff could not provide the auditors with updated or complete documentation of LPMS, Datamart, and/or ORBS, which are key systems, relied on for internal control over financial reporting. The Company has no process in place with regard to the production of user documentation, operations manuals, and training material for LPMS, Datamart, or ORBS. Also, there are no current data dictionaries for LPMS or Datamart on hand.

- The technical LPMS manual provided to the auditor has been a "draft" version since 2005 with no evidence of management review, edit, or approval. In addition, The Company lacked current documentation explaining security roles and profiles and their appropriate assignments to users in LPMS.
- The original documentation given to the auditor for the Datamart consisted of a "Process Flow Diagram" flowchart that was over 11/2 years old. The flowchart did not represent the current configuration of the Datamart for 2008.
- The ORBS executive and project overviews and related database table schematics do not accurately portray the current use of the ORBS database.

The Company has not adequately trained its IT personnel to manage, operate, and maintain LPMS or Datamart without substantial vendor assistance. The lack of documentation and knowledge of its own systems, as well as no contracts, leaves the Company vulnerable to losing control and availability for those information systems in the event a vendor no longer agrees to provide services to the Company.

Without proper system documentation and knowledge, the Company may be unable to determine the nature of data, IT controls, or programs that are critical for its financial reporting needs. As a result, the IT function may not adequately support the financial reporting process and financial reporting errors could likely occur and remain undetected.

Without proper system documentation and knowledge, especially on highly customized systems such as these, systems are subject to errors because:

- Certain control points and specific tables/data are not identified.
- Risk assessments and vulnerability assessments have not been adequately performed.
- A transfer of knowledge and training has not occurred.
- Output and reports are not sufficiently defined
- Security roles, profiles, and their appropriate assignments to users have not been clearly interpreted or maintained.
- Data could be manipulated without management's knowledge by both the vendor and the Company's staff who have inappropriate access.

The Company's management should develop a process and dedicate the necessary internal resources for maintaining up-to-date system documentation, such as operation manuals, training materials, data dictionaries, and other documentation. Management should also provide training to its personnel sufficient to keep LPMS and Datamart operational in the event vendors no longer provide their services. The Company's management should ensure its vendors maintain proper internal controls and current, detailed documentation on all systems and related changes. This documentation should be readily available to necessary Company personnel, auditors, and other appropriate individuals. Current contracts should be obtained for all vendors and SAS 70, Type II audits should be required for all vendors who are service organizations. Management concurred that system documentation was inadequate. Management expressed that it would not be prudent to use Company personnel to document systems that are scheduled to be replaced.

Status of Finding 2008-14 – Partially Resolved

This finding still exists for DataMart. While LPMS is scheduled to be taken out of service in 2010, the Company should require i4 to properly document the code for DataMart. See current year Finding 2009-01 above.

Finding 2008-15
Lack of Information Technology Policies and Procedures

During 2008, the Company lacked the following policies and procedures concerning its use of IT:

- A logical access policy with standardized procedures for the issuance, revocation, and periodic review of system and network user IDs;
- A physical access security policy;
- A policy that classifies data for confidentiality, integrity, availability, and retention requirements;
- An acceptable usage policy defining appropriate business use;
- A network policy and "remote access" policy for granting outside users access to the internal network;
- A policy for IT procurement.

According to Control Objectives for Information and Related Technology published by the IT Governance Institute, entities should:

- Develop and communicate policies and procedures to ensure the achievement of IT objectives and awareness of business and IT risks;
- Establish and maintain IT security roles and responsibilities;
- Establish data ownership, define appropriate security levels and protection controls, and define data retention and destruction requirements;
- Develop and follow a set of procedures that is consistent with the organization's overall procurement process to acquire needed IT-related infrastructure, hardware, software, and services.

Management has not placed sufficient emphasis on the creation and enforcement of IT policies and procedures. Without appropriate IT policies and procedures, there is an increased risk that management (1) may grant inappropriate access to its systems, data, and physical assets; (2) is not effectively managing and safeguarding the confidentiality, integrity, and availability of data; and (3) may not timely and cost-efficiently acquire IT services and/or equipment. In addition, inadequate IT policies and procedures could also result in a lack of recourse if a negative event would occur.

Company's management should develop, implement, and follow appropriate IT policies and procedures and make them available to appropriate Company personnel. Management expressed that the Company does have IT policies and procedures and is in the process of strengthening and documenting those IT policies and procedures.

Status of Finding 2008-15 – Partially Resolved

The Company is in the development process for all IT policies. Drafts and templates of IT policies were reviewed. The drafts and templates are adequate but require alignment with the Company's practices and procedures. A two person team has been established to complete these policies and procedures for presentation to management for approval.

Discussions with the team for review purposes and prioritization of policy completions was conducted. The team appears to be qualified and understands the urgency of policy completion.

The Company has created the following schedule for completion of policies and procedures:

Policy	Completion date	Management or board approval
ITSD103 Media Storage	Q2	Q2
ITAD105 TCP/IP implementation Standards	Q2	Q2
ITAD106 Network Infrastructure Standards	Q2	Q2
ITSD102 IT Security Plan	Q3	Q3
ITSD104 Disaster Recovery	Q3	Q3
ITSD106/ITSD109 IT System Access	Q3	Q3
ITAD107 Computer, Email, Internet Usage	Q3	Q3
ITSD107 IT Security Audits	Q4	Q4